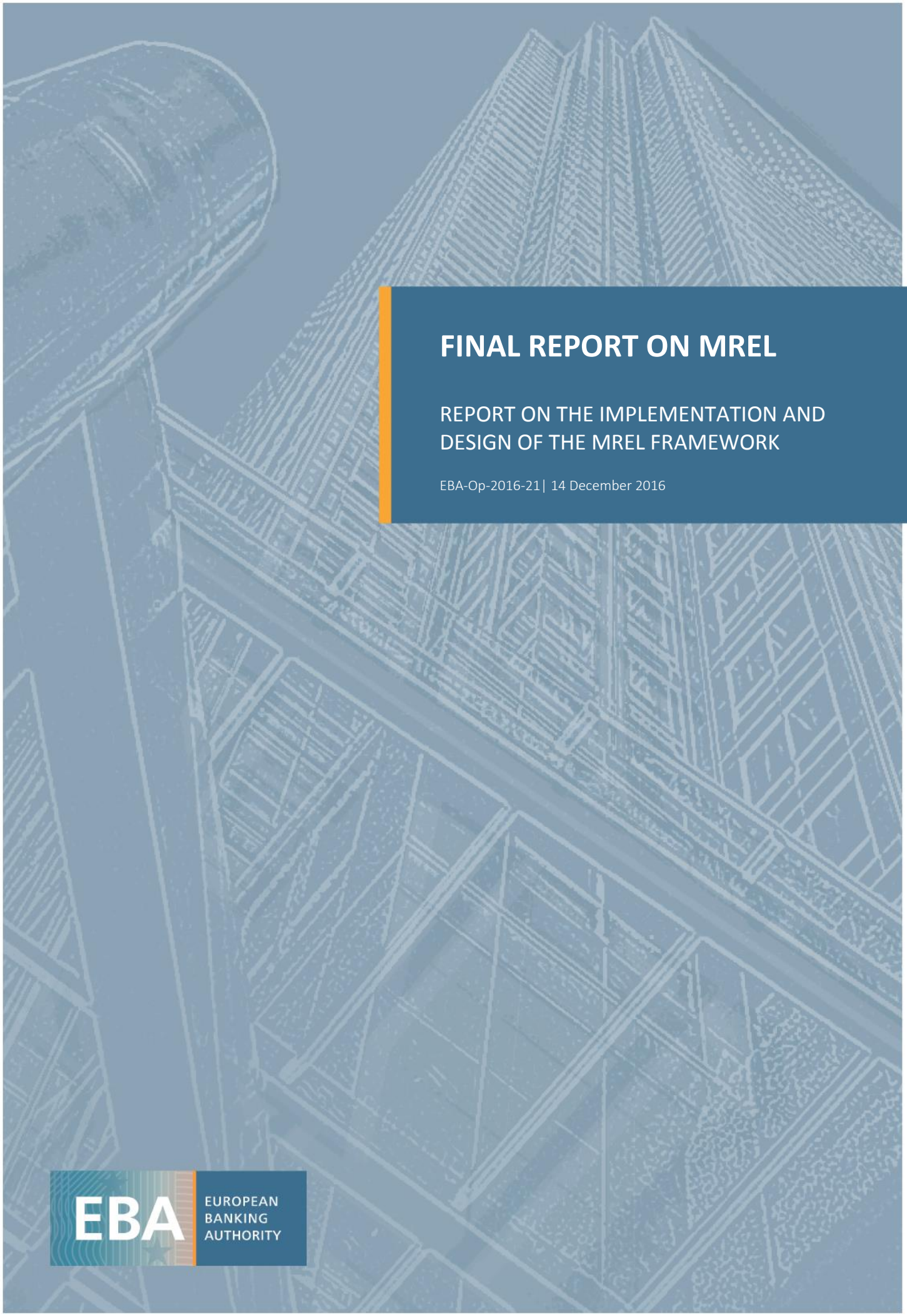


FINAL REPORT ON MREL

REPORT ON THE IMPLEMENTATION AND DESIGN OF THE MREL FRAMEWORK

EBA-Op-2016-21| 14 December 2016

EBA EUROPEAN BANKING AUTHORITY

Contents

List of figures

List of tables

Executive summary

The context

The adoption of the Bank Recovery and Resolution Directive (BRRD)[1] in 2014 brought about a major reform in the EU regulatory framework for banks and was a milestone in addressing the problem of banks being 'too big to fail'.

At the core of this reform is the principle that the costs of bank failures should be borne, first and foremost, by shareholders and creditors rather than taxpayers. In support of this outcome, a new tool, the 'bail-in' tool, enables resolution authorities to write-down shares and debt instruments in order to absorb losses and convert debt instruments into new shares to recapitalise systemic functions.

Bail-in is a crucial element of the resolution reforms but its efficiency depends on whether banks have issued, at the point of failure, enough instruments that are eligible to be bailed-in and that can be bailed-in effectively and credibly without threatening financial stability. This is why the BRRD requires resolution authorities to determine a minimum requirement for own funds and liabilities eligible for bail-in, also known as MREL. In that sense, MREL is an essential complement to the bail-in tool.

The mandate

The BRRD[2] mandates the European Banking Authority (EBA) to deliver a report to the European Commission (the Commission) on the implementation of MREL. The report shall cover a number of areas, including proposals on appropriate adjustments to the parameters of the minimum requirement and consistency with international standards. The report is meant to inform the Commission's legislative proposal on the 'harmonised application' of MREL.[3] The Commission has committed to bringing forward, by the end of 2016, a combined legislative proposal reviewing MREL, as well as implementing the Financial Stability Board (FSB) total loss-absorbing capacity (TLAC) standard[4] in the European Union (EU). At the time of writing, the Commission has published this legislative proposal, which amends several relevant pieces of EU legislation.[5] This report may therefore serve as a useful tool during the legislative process for that proposal.

This report has been drafted to fulfil the EBA's mandate. It follows from an interim version that the EBA provided to the Commission and published for public consultation on 19 July 2016. This final report:

[1] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms, OJ L 173, 12.6.2014, p. 190-348.

[2] Article 45(19) and (20) of the BRRD.

[3] Article 45(18) of the BRRD.

[4] FSB, Principles on the loss-absorbing and recapitalisation capacity of G-SIBs in resolution, TLAC term sheet, 9 November 2015.

[5] http://europa.eu/rapid/press-release_IP-16-3731_en.htm?locale=en.

- Reflects comments received from stakeholders on the interim report and, where relevant, upgrades the provisional recommendations;

- Provides further recommendations on areas not addressed in the interim report;

- Updates the quantitative analysis from the interim report and adds to it by introducing a cost-benefit analysis of the introduction of MREL. It should be stressed that the quantitative analysis and the cost-benefit analysis in this report are necessarily based on various assumptions (including with respect to the capacity of markets to absorb required new MREL issuances) and are subject to substantial caveats. Therefore, caution should be used in interpreting the results.

In the absence of MREL decisions from resolution authorities, not all the issues set out in the BRRD mandate could be addressed in this report. For example, at this stage, it is not possible to assess how MREL has been implemented at the national level, and particularly whether there have been divergences in the levels set for comparable institutions across Member States.

This report has been prepared by the EBA in close cooperation with the Single Resolution Board (SRB) and national resolution authorities in order to draw lessons from their experience of the early stages of MREL implementation. The European Central Bank (ECB) and the Commission were also involved.

Main conclusions and recommendations

At this stage, the EBA has not identified a need to change the key principles underlying the recently adopted delegation regulation on the criteria for setting MREL on an institution-by-institution basis (the regulatory technical standards (RTS) on MREL).[6,7,8] These key principles were: first, that MREL should be set (for each bank) at a level necessary and sufficient to implement the resolution strategy by absorbing losses and recapitalising the institution; and second, that this calibration exercise should be consistent with the prudential capital requirements applicable to the institution before and after resolution. Any amendments to the MREL framework should therefore not lead to the alteration of these principles.

This being said, this report identifies a number of changes necessary with a view to improve the technical soundness of the MREL framework and implement the FSB TLAC standard as an integral component of that framework.

The primary changes proposed in this report are summarised below and reproduced in the table on page 10.

[6] Commission Delegated Regulation (EU) No 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities.

[7] Throughout this report, investment firms are also meant to be covered insofar as the relevant provisions of the BRRD extend to such firms.

[8] This does not preclude technical revisions to the regulation necessitated by the changes proposed to the Level 1 legal text.

First, the EBA supports maintaining a coherent link between MREL and capital requirements. This would be better achieved if both requirements used a consistent denominator, namely risk-weighted assets (RWAs) with (in time) a leverage ratio exposure backstop requirement.

As recommended in the FSB TLAC standard, the EBA's view is that, in order to preserve the **usability of capital buffers**, equity should not be counted towards MREL and capital buffers at the same time. This could be done either by stacking the buffers above MREL or by treating the buffers as a parallel framework to MREL. Nevertheless, it is crucial that a breach of MREL is treated as seriously as a breach of capital requirements, and this should inform the choice between the two approaches. The EBA also recognises that, in the current regulatory set-up, adopting an approach under which the buffers stack above MREL could lead to a mechanical acceleration of automatic **restrictions on voluntary distributions**. In order to address this issue, the EBA proposes that, where a breach of regulatory buffers results from a failure to roll over MREL-eligible debt, there should be the possibility of a suspension of distribution restrictions for a defined period of time, either automatically or on a discretionary basis. During this 'grace period', the institution would have time to repair its MREL capacity by issuing eligible debt.

MREL is an essential factor of a bank's resolvability. It must be met at all times and any breach should trigger an appropriate and proportionate response (which may include MDA restrictions, depending on the approach taken to the relationship between buffers and MREL). The EBA therefore recommends that resolution authorities be given strengthened **powers to respond to a breach of MREL**, including an expedited impediment removal process and the power to require an institution to draw up an MREL restoration plan. The report also suggests that the toolbox of the resolution authority should be further improved through the introduction of powers to proactively monitor and manage the maturity of an institution's MREL stack. A redemption approval regime should also be implemented to ensure that there is an approval requirement for any redemption by an institution of an MREL-eligible instrument where that redemption would bring the institution into breach of its MREL requirement (or combined buffer requirement (CBR) if this stacks on top of MREL) or where the institution is already in breach of its MREL requirement. In addition, the EBA has considered the **interaction between resolution authorities and competent authorities** in responding to an MREL breach and has proposed an approach that aims to ensure consistency and coordination depending on the nature of that breach.

The subordination of MREL-eligible instruments is important both for the signal it sends to investors about the loss absorbency of the instruments and to avoid 'no creditor worse off' (NCWO) issues. The report recommends requiring that globally systemically important banks (G-SIBs) meet their MREL with subordinated instruments at least to a level of 14.5% of RWAs (+ CBR) in line with the TLAC term sheet. In addition, considering the systemic importance of other systemically important institutions (O-SIIs)[9] but also the level playing field and cost considerations, it is recommended to also require O-SIIs to meet a subordination requirement of 13.5% of RWAs (+ CBR). However, taking into account the heterogeneity in the O-SII population, authorities should be given some flexibility in applying this subordination requirement.

[9] As identified under the conditions of Article 131(3) of the CRD.

Loss-absorbing capacity should be distributed **within groups** with a view to best support the resolution strategy for the group by passing losses from the entities where they originate to the entities where resolution action is implemented. In the EBA's view, EU material subgroups of third-country G-SIBs should be required to collectively meet a level of MREL in line with the TLAC term sheet. For the broader population of banks, subsidiaries should meet an internal MREL requirement governed by an updated intragroup framework, with instruments that are internally issued subordinated and subject to extended write-down clauses. In addition, with a view to addressing the costs arising from prepositioning MREL instruments at the level of every entity, the EBA recommends that resolution authorities should be able to authorise banks to count collateralised guarantees towards meeting their MREL requirement under certain conditions. At this stage, it was deemed premature to recommend the admissibility of non-collateralised guarantees; instead, a BRRD review clause could provide for further proposals based on a future EBA report.

The EBA further makes a recommendation for harmonised **reporting and disclosure** requirements in the area of MREL. Disclosing the MREL requirements and capacity of banks, at least in the steady-phase, would carry some important benefits. It would provide transparency to investors and thus support market discipline, decrease speculations about banks' health and facilitate appropriate pricing. At a minimum, during the transition period investors should be aware of information on the creditor hierarchy applicable to the instrument and the overall MREL quantum and composition for each institution.

Finally, this report provides a quantitative analysis of the MREL stack and funding needs of banking groups operating in the EU, as well as a preliminary analysis of the potential macroeconomic impact of the introduction of MREL. The findings in this report are subject to several important methodological caveats and must be treated with caution. In particular, in the absence of MREL decisions for institutions to date and given the limited information on authorities' MREL policy approaches, assumptions had to be made as to the scope and calibration of MREL. These assumptions are, by definition, different from the actual levels of MREL that will ultimately be determined for each institution and group. In addition, while the methodology employed with regard to the macroeconomic impact assessment is similar to work undertaken by other organisations in this area, it is (by definition) based on various assumptions regarding the capacity of markets to absorb new MREL issuances (which cannot be adequately assessed at this stage).

Final recommendations

Number	Topic	Final recommendations
1	**Reference base for the MREL requirement (denominator)**	The EBA recommends that the reference base for the MREL requirement should be changed from total liabilities and own funds (TLOF) to RWAs. This should be complemented with a leverage ratio exposure backstop requirement, in parallel with its phase-in within the capital framework. This approach achieves alignment with the CRR/CRD regulatory requirements and with the FSB TLAC standard. It also reduces complexity without major substantive changes to the MREL setting process. If this change is not made, the EBA recommends changing the reference base of MREL from TLOF to the leverage ratio exposure as a more consistently applied non-risk-sensitive measure. If none of these changes are made, the EBA considers that clarification of the definition of the existing denominator is necessary, either in the Level 1 text or through the introduction of a Level 2 mandate.
2	**MREL stacking order**	The EBA recommends that, in principle, the usability of regulatory capital buffers would be best preserved if Common Equity Tier 1 (CET1) in the CBR could not also count towards meeting the MREL requirement. Therefore, banks in the EU should not be able to use the same CET1 capital to meet MREL and also to meet regulatory capital buffers. The EBA's view is that the stacking order approach (under which the buffers are stacked on top of MREL) should be implemented since it is in compliance with the TLAC term sheet and treats MREL and capital requirements in a contiguous and integrated manner. Nevertheless, careful consideration should be given to the interaction of the stacking order approach with automatic maximum distributable amount (MDA) restrictions on voluntary distributions, and the need for a capital conservation plan. This is particularly relevant for banks that rely mainly on capital instruments to meet MREL due to limited or no access to debt capital markets, including international markets. Therefore, the additional recommendations on the interaction of MREL and the MDA regime made in this report should also be adopted. On the other hand, if the parallel framework approach were to be adopted (under which the buffers stack on top of minimum capital

		requirement only, and not MREL), the provision for resolution authorities of an appropriate toolkit to deal with MREL breaches would become even more important.
3	**Interaction between MREL and the MDA framework**	The EBA recommends that competent authorities and resolution authorities should be required to inform each other of potential breaches of capital or MREL requirements as they become aware of them through their respective monitoring processes. To the extent that the stacking order approach is adopted, the legislative framework should introduce a suspension in the automatic triggering of distribution restrictions under the MDA framework where the breach relates to a failure to roll over or issue sufficient MREL-eligible debt. This suspension could either arise automatically or on a discretionary basis following consideration of the circumstances by the authorities. In both cases, the length of the grace period should be clearly specified and possibly be subject to a renewal decision by the authorities. There should be heightened supervisory and resolution authority engagement with the institution during the grace period. If the institution has been unable to issue or reissue MREL-eligible debt to restore the CET1 in its CBR at the end of the grace period, the MDA framework response would then apply. The provisions of Article 142 of the CRD should be updated to ensure that the need for a capital conservation plan is not triggered by a breach of the CBR arising from the failure of an institution to roll over or issue sufficient MREL-eligible debt. Instead, in these circumstances, an MREL conservation plan should be required in which the institution would specify how it would restore compliance with its CBR. The adequacy of the MREL conservation plan should be assessed by the resolution authority in consultation with the competent authority. If the plan is deemed to be inadequate, the resolution authority should be able to use its impediment removal powers to address the institution's breach of its CBR on the basis that an impediment to resolvability is created by the institution (by using going concern capital from its CBR to meet a gone concern MREL requirement). Finally, the possibility that an institution may breach its CBR and be subject to MDA restrictions as a result of a failure to roll over (otherwise unrelated) MREL-eligible instruments should be clear to investors in relevant instruments. Furthermore, the general disclosure requirements discussed in Section 9 below should also take this issue into consideration.

4	**Breach of MREL**	The EBA recommends that resolution authorities and competent authorities should engage in active monitoring of compliance with their respective requirements. The powers of resolution authorities to respond to an MREL breach should be enhanced. In particular, resolution authorities should be given the power to: (i) require the preparation and execution of an MREL restoration plan; (ii) utilise powers to remove impediments to resolvability relating to MREL compliance on an expedited basis; (iii) request that distribution restrictions be imposed on the institution by the competent authority; and (iv) request a joint restoration plan in cases where an institution breaches both MREL and minimum capital requirements. The response to a given breach should depend on the source of that breach, with the lead authority clearly specified and the other authority in a consultation role. The competent authority should be in the lead role in responding to losses that result in a breach of minimum capital requirements as well as MREL. The resolution authority should be in the lead role in responding to a failure to issue or roll over MREL-eligible debt leading to a breach of MREL (and possibly the CBR if the stacking order approach is adopted). If there are both losses and a failure to roll over or issue, both authorities should attempt to agree on a joint restoration plan (provided that both authorities believe that the institution is not failing or likely to fail). At all stages, there should be close cooperation and coordination between the authorities. Finally, the actions taken by the authorities should be proportionate to the nature and extent of the breach in question. The above-mentioned approach could be laid down in Level 1 legislation and/or further specified via RTS or Guidelines.
5	**Redemption and maturity management**	The EBA recommends that the legislative framework should contain a requirement for resolution authorities to monitor the maturity profile of the MREL-eligible instruments of each institution for which an MREL requirement has been set. Proactive monitoring of the maturity profile of the MREL stack should ensure that institutions' MREL positions are maintained should access to markets be temporarily impaired. This would ensure consistency with the TLAC standard. Resolution authorities should be provided with explicit power to gather the necessary information on a regular basis in order to

		facilitate this monitoring. This power should be exercised in coordination with the competent authority (to avoid duplicating monitoring requirements), as the competent authority also has an interest in monitoring the maturity profile of MREL given its potential impact on the CBR under the stacking order approach. In order to ensure the harmonisation of the data collected within the EU, the EBA could be empowered to draft implementing technical standards (ITS) establishing the data to be collected from institutions as part of this monitoring exercise. This could be linked to any general mandate to develop ITS on MREL reporting requirements, such as that proposed in this report. The EBA could be further mandated to adopt technical standards to foster the harmonisation of the application of the requirement and power. The EBA further recommends that the legislative framework should contain a power for the resolution authority to request an institution to modify the maturity profile of its MREL stack. Such a power should be available where the resolution authority is of the view that the maturity profile of the institution's existing MREL-eligible instruments constitutes an impediment to the resolvability of the institution. The use of the power could follow a more expedited process than the existing impediment removal process set out in the BRRD. When exercising this power, the resolution authority should be required to consult with the competent authority. In addition, the EBA recommends that a redemption approval regime should be introduced for MREL-eligible instruments. Where the institution knows, or reasonably believes, that a proposed redemption would lead to a breach of its MREL requirement or where it is already in breach of its MREL requirement, it should be required to notify the resolution authority of this before undertaking the redemption. If the instrument it proposes to redeem is a capital instrument, it should also be required to notify the competent authority that the redemption may lead to a breach of its MREL requirement or that it is already in breach of its MREL requirement. For capital instruments, the ultimate approval would continue to rest with the competent authority under the existing capital redemption approval regime, although the competent authority would be required to consult the resolution authority where there might also be a breach of MREL or where there was an existing breach of MREL. For non-capital instruments that are being counted towards MREL, the resolution authority would ultimately be responsible for approving the redemption. Nevertheless, the resolution authority should consult the competent authority within a defined time frame in these circumstances. In the absence of approval, the institution should not be entitled to redeem the

		instrument.
6	**Treatment of cross-holdings of MREL-eligible instruments**	The EBA recommends that exposures to MREL-eligible instruments issued by all credit institutions should be deducted from MREL on a like-for-like basis[10] above a double threshold meant to preserve a share of market-making activity. Holdings of senior instruments should only be deducted to the extent that they are eligible for MREL (the proportionate deduction approach), unless the large exposure limit approach set out below is adopted for issuances of non-G-SIBs. While this solution departs from the Tier 2 base recommended by the Basel Committee on Banking Supervision (BCBS), the EBA considers this departure justified in the EU context where all banks are subject to an MREL requirement. Alternatively, deduction from the Tier 2 base could be retained with a view to full compliance with the BCBS recommendation. In addition, if a deduction regime was considered as hindering the development of the market for MREL instruments issued by non-G-SIBs, an ad hoc large exposure sub-limit should be introduced for holdings of MREL-eligible instruments issued by those banks within the large exposure limits set out in Article 395 of the CRR. The calibration of the sub-limits should rely on an impact analysis, taking into account the effect on non-G-SIBs, consistency with the deduction approach and consistency with the overall large exposure framework. These elements could be analysed in the context of an EBA report and eventually set out via RTS. Given that one of the objectives underpinning this option is simplification, holdings of senior instruments issued by non-G-SIBs would be fully included in the limit rather than on the proportionate basis described above.
7	**Subordination**	The EBA makes the following recommendations on the level and form of subordination required from banks. With regard to the level of subordination: • Under the revised framework, G-SIBs should be required to meet their MREL with subordinated instruments, at least to a level of 16% of RWAs in 2019 and 18% of RWAs in 2022 in line with the TLAC term sheet; • The revised framework should also contain, mutatis mutandis, the grounds for exemptions to subordination provided in Recommendation 11 of the TLAC term sheet. Accordingly, subordination would not be required to the extent that the

[10] As explained above, the treatment of holdings of MREL-eligible instruments that also qualify as capital instruments is beyond the scope of this report and will remain governed by the CRD/CRR.

		amount of excluded liabilities that rank pari passu or junior to MREL-eligible liabilities does not exceed 5% of MREL-eligible instruments. Alternatively, resolution authorities should be able to set a subordination requirement for G-SIBs not lower than 13.5% of RWAs in 2019 and 14.5% of RWAs in 2022. In both cases, the conditions of the term sheet should apply; in particular, the derogation should not give rise to a material risk of a successful legal challenge or valid NCWO claims. This risk assessment should either be made on a case-by-case basis or on the basis of a sensitivity threshold set by the BRRD; • With regard to O-SIIs, the EBA believes that there is merit in introducing a subordination requirement at a level of 13.5% of RWAs with an appropriate transitional period. This subordination requirement would improve the resolvability of O-SIIs and alleviate NCWO concerns while preserving the level playing field. It would also contribute to the predictability of the EU resolution regime; • The EBA recognises that the ability of banks to issue instruments at reasonable costs without undermining their medium-term viability depends on current market access and capacity, including access to deep, developed markets, and on the evolution of these conditions going forward. This evolution in capacity should be closely monitored. It cannot be adequately assessed at this stage, not least because a subordination requirement for O-SIIs would only be phased-in over several years; • In addition, the EBA recognises the heterogeneity across O-SIIs in Europe and the possibility for differentiated resolution strategies. NCWO concerns would be particularly acute in a whole bank bail-in strategy, as compared, for example, to cases where the preferred strategy is liquidation or a partial transfer of preferred deposits; • Therefore, alongside the 13.5% subordination requirement for O-SIIs, resolution authorities should be provided with a power to adjust that requirement for an O-SII on a case-by-case basis, taking into account the resolution strategy for the institution, the relevant debt market for that bank, and its liability structure; • For any bank, it should be noted that the current BRRD framework already empowers resolution authorities to require subordination on a case-by-case basis. This power should be maintained and exercised where subordination is not already required or not required to the same extent by the requirement described above. With regard to the form, subordination should be met with instruments subject to structural, statutory or contractual

		subordination. The EBA does not recommend a particular form of subordination. However, the various national options for statutory subordination should be harmonised. A single statutory subordination option would improve investor clarity and facilitate resolution planning (including the identification of NCWO concerns) and resolution action, especially for cross-border groups.
8	**Third-country recognition requirements**	The EBA recommends that some reduction of the burden of compliance with third-country recognition requirements be introduced. This could be achieved by narrowing the scope of the requirement while maintaining the effectiveness of contractual recognition for MREL liabilities. In order to do so, resolution authorities should be given the power to waive the application of Article 55 for certain instruments where it would be impractical for such a requirement to apply. Given the wide nature of such discretionary waivers, and in order to ensure harmonised application and a level playing field, the EBA could be mandated to further specify the circumstances in which it might be impractical to include such a term in an instrument in order to justify the granting of a waiver from the requirements of Article 55.
9	**Adequacy and calibration**	The EBA recommends that the calibration of MREL should, in all cases, be closely linked to and justified by the institution's resolution strategy. Business models may be worth considering when calibrating MREL to the extent that they translate into differences in resolution strategies. The EBA further recommends that the current MREL assessment framework (under Article 45 of the BRRD and the RTS on MREL) be retained as the basis for setting Pillar 2/firm-specific MREL requirements. This means that MREL should be set as the higher of the requirement resulting from this firm-specific assessment and any Pillar 1 requirement, should one be introduced. Firm-specific requirements should be set only at levels necessary to implement the resolution strategy.
10	**Intragroup issues**	The EBA recommends that the MREL framework should be amended to provide for the identification of resolution entities and the allocation of internally issued, subordinated MREL at the non-resolution-entity level. In addition, the legislative framework should include a requirement to include contractual provisions allowing the write-down or conversion of MREL instruments, or alternatively an extension of the scope of Article 59 (point of non-viability (PONV) write-down) to all internal MREL instruments rather than only capital. Under a revised intragroup framework, the EU should be treated as a

		single jurisdiction from the point of view of the internal TLAC (iTLAC) requirement. Consequently, the BRRD should implement a minimum internal requirement for material subgroups of foreign G-SIBs in the EU. In any event, EU subsidiaries of EU G-SIBs will be adequately covered by MREL. Under a revised BRRD resolution, authorities should be able to authorise a subsidiary to count collateralised guarantees provided by the parent towards meeting its individual MREL requirement under strict conditions. Guarantees should be collateralised and backed by liquid low-risk assets, unencumbered by third parties. The decision to accept collateralised guarantees should be made jointly by resolution authorities in the context of the resolution planning exercise, on the basis of an explicit assessment that ensures that the type of guarantee proposed by the institutions does not give rise to current or foreseen material, practical or legal impediments to the prompt transfer of own funds or repayment of liabilities to the subsidiary by its parent. In order to facilitate this assessment, the BRRD (with further specification in RTS) should define sound criteria regarding the collateralisation of guarantees. Collateral should be marked to market and be sufficient to cover the amount guaranteed (including a precautionary haircut). The institution requesting to use collateralised guarantees to meet its MREL requirement may also be required to produce legal analysis to support the legal enforceability of the instruments. Further work should be done (for example, in an EBA report) to explore whether, and under which criteria, non-collateralised guarantees could constitute viable loss-absorbing capacity, and thus potentially be introduced as an admissible form of MREL. In particular, the report would need to assess whether a subsidiary can enforce such an arrangement (and under what time frame) in case the parent refuses to honour it, especially on a cross-border basis. The report would also reflect on the way in which to cater for situations where a parent would not be in a financial position to honour the guarantee, as there would be a need for reassurance that the authority responsible for the parent would ensure that the parent is resolved and the subsidiary preserved. A review clause should be introduced in the BRRD whereby, based on the conclusions of the report, the Commission could make appropriate proposals with a view to counting non-collateralised guarantees towards MREL. Finally, it is recommended (as part of the upcoming legislative review) to assess whether the regime for waivers in Articles 45(11) and (12) ensures neutrality across group structures or needs to be extended to also cover institutions for which capital requirements have been

		waived pursuant to Article 10 of the CRR.
11	**Reporting**	The EBA recommends that the BRRD should provide for an explicit obligation for credit institutions to regularly report their level and composition of MREL instruments to resolution authorities. This information should be shared with competent authorities. The EBA should be empowered to develop ITS laying down uniform rules and templates for the reporting of MREL-related data by credit institutions. The reporting ITS should also allow for the collection of other data on liabilities for resolution planning and bail-in execution, and should be based—to the largest extent possible—on existing frameworks developed by resolution authorities for the collection of MREL-related and other liabilities-related data. The ITS should define a reporting schedule, but the BRRD should explicitly allow the resolution authority to require an ad hoc collection at any time. In addition, with a view to the possible integration of supervisory and resolution reporting processes, the Level 1 text and the ITS should allow (as an option) for the resolution authority to delegate the collection of data to the competent authority, which would then be shared with the resolution authority. To facilitate this process, the template should make use (whenever possible and appropriate) of the techniques and fields already used in the FINREP and Common Reporting (COREP) ITS (Reporting Regulation 680/2014).
12	**Disclosure**	The EBA recommends that in the steady state, credit institutions in the EU should be required to disclose the quantum and composition of their MREL-eligible liabilities, as well as the MREL required from them by the resolution authority. The BCBS recommendations, once finalised, should serve as a starting point and should be extended to cover all of the MREL-eligible liabilities of G-SIBs and non-G-SIBs. They should also be extended to include information on other financial instruments subject to bail-in as well as information on the creditor hierarchy. In the transitional period, and pending finalisation of the BCBS recommendation in this area credit institutions in the EU should be required to disclose to investors the quantum and composition of their stack of MREL-eligible liabilities, as well as information on the creditor hierarchy (at a minimum). In addition, disclosure should be required or actively encouraged if a failure to roll over MREL debt could lead to automatic restrictions on distributions.

1. Introduction

The 2008 financial crisis led to government bail-outs of banks around the world. The subsequent impact on public finances and the undesirable incentive effects of socialising the costs of bank failure have underscored the fact that a different approach is needed.

Significant steps have been taken to address the potential spillovers between banks and sovereigns, and thereby to reduce the systemic risks of failing banks. The BRRD provides a common resolution regime in the EU that allows authorities to deal with failing institutions and ensures cooperation between home and host authorities. In the future, the costs of bank failure will have to be borne first and foremost by shareholders and creditors, minimising moral hazard and risks to taxpayers. Removing the implicit subsidy of systemic banks by governments will avoid the build-up of excessive risk and leverage within banks and the banking system as a whole.

To avoid institutions structuring their liabilities in a way that impedes the effectiveness of bail-in or other resolution tools, and to avoid the risk of contagion or bank runs, the BRRD requires that institutions meet (at all times) a robust MREL expressed as a percentage of institutions' TLOF. This MREL requirement should ensure that shareholders and creditors bear losses regardless of which resolution tool is applied (e.g. the bail-in tool or the bridge bank tool). In this way, MREL ensures sufficient loss-absorbing and recapitalisation capacity to enable orderly resolution, facilitating the continuity of critical functions without recourse to public funds.

These policy goals have also been recognised at the international level, where the FSB TLAC standard[11] has set minimum levels of loss absorption and recapitalisation capacity for G-SIBs.

Following the adoption of the BRRD, the EBA has elaborated RTS further specifying the criteria relating to the methodology for setting MREL. This RTS was adopted as a delegated regulation by the Commission on 23 May 2016,[12] paving the way for its implementation by resolution authorities.

Article 45(19) of the BRRD mandates the EBA to deliver a report to the Commission that should serve as a basis for a proposal on the harmonised application of MREL. The report shall cover a number of areas, including proposals on appropriate adjustments to the parameters of the minimum requirement and consistency with international standards.

Although the TLAC term sheet and the MREL provisions of the BRRD are already compatible in most respects, the Commission has committed to bringing forward a legislative proposal amending the MREL framework to ensure full implementation of the TLAC standard in the EU. This proposal also addresses the mandate in Article 45(18) of the BRRD for the Commission to

[11] http://www.fsb.org/2015/11/tlac-press-release/.

[12] Commission Delegated Regulation (EU) No 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the RTS specifying the criteria relating to the methodology for setting MREL.

bring forward (if appropriate) proposals on the harmonised application of MREL by the end of 2016.

At the request of the Commission, the EBA has issued an interim version of this report on 19 July 2016, which was intended to provide timely input for the Commission's deliberations and to elicit input from other stakeholders.

The recommendations and analysis of the interim report have now been re-evaluated and updated where relevant, with regard to public feedback on the interim report and further analyses carried out by the EBA.

This final report has been prepared by the EBA in close cooperation with the SRB and national resolution authorities in order to draw lessons from their experience of the early stages of MREL implementation. The ECB and the Commission were also involved. The interim report contained a number of provisional recommendations that have been re-examined in light of feedback and further analyses. Some of these provisional recommendations have been maintained as final recommendations. Other recommendations have been revised. The quantitative analysis contained in the interim report has been updated and improved upon, and this final version of the report is complemented by a cost-benefit analysis. Nevertheless, it should be emphasised that the quantitative analysis and cost-benefit analysis contained in this report are necessarily based on various assumptions (including with regard to the capacity of markets to absorb additional MREL issuances) and are subject to a number of caveats. Therefore, the results should be interpreted with caution.

On 23 November 2016, the Commission brought forward proposals that, inter alia, aim to incorporate TLAC into the EU legal framework and to improve the existing MREL framework.[13] These proposals entail amendments to various pieces of relevant EU legislation, namely the BRRD, the Single Resolution Mechanism Regulation (SRMR),[14] the Capital Requirements Regulation (CRR), [15] and the Capital Requirements Directive (CRD). [16] The Commission's proposed amendments will now be discussed by the European Council and European Parliament with a view to their adoption. This report can serve to facilitate those discussions.

Next steps

Given the stage of implementation of MREL in the EU, this final report was not able to address all the issues included in the EBA's mandate in Article 45(19) and 45(20) of the BRRD. The EBA intends to continue to analyse the implementation of MREL and TLAC in the EU and to publish further reports and analyses on the implementation of MREL and TLAC in the EU.

[13] http://europa.eu/rapid/press-release_IP-16-3731_en.htm?locale=en.

[14] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010

[15] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

[16] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

2. State of play regarding MREL and TLAC implementation

The BRRD entered into force on 1 January 2015 with a requirement to transpose bail-in and MREL provisions into national law by 1 January 2016. Transposition is now complete in all Member States. As mandated by the BRRD, the EBA adopted draft RTS specifying the criteria relating to the methodology for setting the MREL requirement. On 23 May 2016, the Commission adopted a delegated regulation[17] endorsing, with limited amendments, the draft RTS. This delegated regulation (the RTS on MREL) has been subjected to the scrutiny of the European Parliament and the Council and, in the absence of any objections from those institutions, entered into force on 3 September 2016.

With the BRRD, the SRMR and the RTS on MREL, resolution authorities now possess a broad set of regulatory provisions to determine MREL for all credit institutions across the internal market on a consistent basis. It is now their responsibility to determine, in the context of resolution colleges and in line with resolvability assessments, the resolution strategy for each firm and the level of MREL sufficient to implement it. In this regard, an important dimension will be for resolution authorities to set appropriate transitional periods tailored for each and every institution, respecting the general principles set out in the BRRD and in the RTS on MREL.

At this stage, resolution planning is still at an early phase for most institutions. A significant number of resolution colleges are taking place in the final months of 2016 and some resolution authorities are considering providing indicative or informative MREL requirements in this context. Many institutions are already adjusting their funding structures and projections show that—depending on the possible calibrations—a number would already be in position to meet a steady-phase assumed calibration.

At this stage, no actual MREL decision has been taken by resolution authorities. Therefore, further work will be necessary beyond the completion of this report to provide a comprehensive assessment and overview of MREL implementation across the EU.

To date, three resolution authorities (the Bank of England (United Kingdom),[18] the SRB (the Banking Union),[19] and the Swedish National Debt Office (Sweden))[20] have either published their policy or publicly communicated their policy intentions for setting MREL for institutions in their jurisdictions. These are the three EU resolution authorities responsible for setting MREL for G-SIBs established in the EU. Other than the United Kingdom, final policy decisions have not been taken at the date of publication of this report. Although approaches remain subject to change in most

[17] Commission Delegated Regulation (EU) No 2016/1450 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the RTS specifying the criteria relating to the methodology for setting MREL.

[18] Cf. http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf.

[19] Cf. http://srb.europa.eu/sites/srbsite/files/2nd_industry_dialoge_12-1-2016_-_mrel.pdf.

[20] Cf. https://www.riksgalden.se/Dokument_eng/financial%20stability/mrel-consultation-paper.pdf.

cases, a comparison of the key features of MREL implementation across resolution authorities in the EU can be found in Annex 2.

All three approaches are based on the framework established by the BRRD and the RTS on MREL, which links the setting of MREL with an assessment of the amount of liabilities and own funds needed to absorb losses and to recapitalise an institution in implementing its resolution strategy. These assessments should, in turn, be closely linked to the institution's prudential capital requirements.

Nevertheless, a number of differences in approach are worth highlighting:

- **Degree of specificity** – The United Kingdom policy and Swedish consultation set out the treatment of institutions depending on their resolution strategies and provide explicit thresholds that serve as indicative proxies for those strategies; the SRB has not done this yet. This may, in part, reflect the fact that there is a greater diversity of institutions within the Banking Union than within any one Member State, making the identification of an appropriate classification of institutions challenging;
- **Treatment of capital buffers (stacking)** – The United Kingdom policy introduces a requirement that firms should not count CET1 towards meeting MREL and capital buffers simultaneously. This mirrors the approach taken in the FSB TLAC standard;
- **Treatment of capital buffers (recapitalisation)** – The United Kingdom policy will not include capital buffers in the recapitalisation amount (RCA), whereas the Swedish proposal would include capital buffers in the RCA. The SRB proposal would not include buffers in the RCA, but would partially count them as part of a market confidence charge (MCC);
- **Subordination** – The United Kingdom requires subordination of MREL-eligible liabilities for institutions with a bail-in resolution strategy, and will make a case-by-case decision for other banks. The SRB expects G-SIBs to comply, at the minimum, with the TLAC term sheet with respect to subordination and further proposes a case-by-case decision for other banks.

As noted above, in parallel with the development of MREL policy approaches by resolution authorities, the Commission has introduced a legislative proposal on the implementation of the FSB TLAC standard for G-SIBs in Europe.[21] This proposes to amend the MREL framework in a number of places so that banks will need to meet a single loss-absorbing capacity standard. A number of other G-SIB home jurisdictions (e.g. the US[22] and Switzerland)[23] have also carried out consultations on TLAC implementation in their respective jurisdictions. Annex 3 compares the key features of the current MREL framework, the FSB TLAC term sheet, and the proposed US and Swiss implementations of the term sheet. Some key points to note from this comparison are:

- **Scope** – Both the TLAC term sheet and the US and Swiss implementations apply only to G-SIBs, whereas the MREL framework applies to a much broader set of institutions;[24]

[21] http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

[22] https://www.federalreserve.gov/newsevents/press/bcreg/20151030a.htm.

[23] https://www.finma.ch/en/~/media/finma/dokumente/dokumentencenter/myfinma/faktenblaetter/faktenblatt-too-big-to-fail-regime-verstaerkt.pdf?la=en.

[24] In this context, it may be interesting to note that the Canadian law implementing the TLAC standard will be applied to all domestically systemically important banks (D-SIBs) in Canada.

- **Calibration** – The FSB TLAC term sheet sets a minimum level of TLAC as a percentage of RWAs (18% from 2022), with a leverage ratio denominator requirement (6.75% from 2022) as a backstop and with scope for national authorities to set additional firm-specific requirements on top of this. The US proposals do not include additional firm-specific requirements, but set the leverage ratio denominator requirement at a higher level (9.5%).[25] The Swiss proposals set both the RWA requirement and the leverage ratio denominator requirement at a higher level than the TLAC term sheet.

2.1 Qualitative survey of resolution authorities

To assess the current readiness of European resolution authorities (i.e. the 28 national resolution authorities and the SRB) and to evaluate the potential impact of the implementation of MREL requirements on specific types of institutions[26] in individual Member States, the EBA conducted a qualitative survey in April 2016 addressed to national resolution authorities and the SRB.

Twenty-six resolution authorities (including the SRB) completed the survey. Resolution authorities indicated that the answers provided were preliminary and may evolve over time. As a result, the findings should be considered as indicative policy considerations rather than as reflecting the resolution authorities' final policy stances. As of December 2016, no resolution authority has made a decision regarding the setting of MREL for any institution.

Where relevant, responses received from resolution authorities in the Member States inside and outside the Banking Union are presented separately. Responses from national resolution authorities inside the Banking Union related to less significant institutions (LSIs) but acknowledged that MREL policy for all banks in the Banking Union would be established in tandem with the SRB.

The main findings of this qualitative survey on MREL are summarised Table 1 below.

[25] However, comparability between leverage ratio requirements is limited due to differences in accounting standards (International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP)).

[26] The quality and quantum of MREL-eligible liabilities may be a particular issue for institutions with particular legal forms or governance models, given activity and funding restrictions under national law or the ability to access capital markets in general. Specific definitions of types of institutions that may find it difficult to meet the MREL requirement were not predefined because the main factors affecting such a determination (systemic relevance, materiality criteria, funding model, legal form/governance, etc.) and their thresholds were highly variable across Member States.

Table 1: Results of the qualitative survey on MREL

No	Finding	Description (based on the survey results in April 2016)
1	**Resolution authorities responsible for most significant institutions in the EU have publicly communicated their proposed policy approach to setting MREL**	At the time of the survey (April 2016), the SRB and two national resolution authorities in Member States outside the Banking Union—the Bank of England (United Kingdom)[27] and the Swedish National Debt Office (Sweden)—had publicly communicated their intended policy approach to setting MREL. Together, these authorities are responsible for all G-SIBs established in the EU. Resolution authorities within the Banking Union will implement the MREL policy for significant institutions in line with the approach proposed by the SRB. With regards to LSIs in the Banking Union, the MREL policy that will be implemented by resolution authorities will be defined in close collaboration with the SRB in order to align the approach to the MREL policy adopted for significant institutions.
2	**MREL is to be set based on systemic importance and/or resolution strategy rather than a business model**	When setting MREL, resolution authorities both within and outside the Banking Union indicated their intention to follow the approach laid down in the BRRD and the RTS on MREL. Most resolution authorities that provided preliminary MREL policy stances intended to differentiate MREL targets based on the resolution strategy or systemic importance of an institution. A few resolution authorities considered differentiation of MREL targets based on G-SIB/O-SII classification, type of governance or size. Only three respondents directly related MREL to business models.
3	**Resolution authorities intend to adjust loss absorption amount downwards; a few may consider upward adjustment**	Resolution authorities outside the Banking Union envisaged downward adjustments to the loss absorption amount, mostly for some parts of the CBR (capital conservation, countercyclical or systemic risk buffers). Other Pillar 2 capital requirements determined on the basis of the outcome of stress tests or to cover macroprudential risks were also considered to be excluded. Some resolution authorities considered case-by-case upward adjustments to the loss absorption amount. A few resolution authorities excluded this option in principle or considered it not probable. For resolution authorities in the Banking Union, potential upward or downward adjustments on a case-by-case basis could be made, taking into account information from the supervisory review and evaluation process (SREP), barriers or impediments to resolvability,

[27] The United Kingdom has subsequently finalised its policy, as set out above and in Annex 2 below.

No	Finding	Description (based on the survey results in April 2016)
		and other information.
4	**Differing approaches to including buffer requirements in the RCA**	There were different views among resolution authorities outside the Banking Union: some were explicit that the RCA should include buffers, one resolution authority held the opposite view, and others considered that a case-by-case assessment was needed or had no policy views. Within the Banking Union, the RCA is likely to be determined based on the resolution strategy and critical functions that need to be preserved. An adjustment to maintain market confidence following a peer group comparison was supported by two resolution authorities outside the Banking Union and several resolution authorities in the Banking Union, but most resolution authorities do not have final views yet.
5	**Resolution authorities have not yet decided on their approach to subordination**	A few resolution authorities outside the Banking Union considered that subordination might be required for institutions subject to a bail-in resolution strategy. For others, the policy has not yet been developed or will be made on a case-by-case basis. Resolution authorities within the Banking Union indicated that subordination could be required based on the feasibility and credibility of bail-in instruments on a case-by-case basis. The preferred form of subordination differed across Member States. A few resolution authorities referred to changes in the hierarchy of the insolvency regime to mitigate NCWO risk.
6	**Deposit-funded banks, cooperative banks or other institutions with limited access to financial markets were most commonly identified as likely to find it difficult to meet MREL requirements**	The predominance of covered or preferred retail deposits in the funding structure and limited or non-existent experience in issuing debt instruments were found to be the main factors affecting institutions' abilities to meet MREL. Three resolution authorities in the Banking Union and one outside the Banking Union referred to the potential use of the Deposit Guarantee Scheme (DGS). Resolution authorities reported that issuing MREL instruments might raise more acute problems for institutions in Member States with less developed capital markets. Such institutions were likely to rely on CET1 instruments to meet MREL.

No	Finding	Description (based on the survey results in April 2016)
7	**MREL-eligible debt is usually issued under domestic law and denominated in domestic currency**	Most resolution authorities in the Banking Union reported MREL-eligible debt issuances were denominated in EUR. Resolution authorities outside the Banking Union indicated issuances in domestic currency and in EUR. A few resolution authorities mentioned issuances in USD. MREL-eligible debt is usually issued under domestic law, but issuances under (foreign) English law and the law of other Banking Union Member States were frequently reported. Two resolution authorities outside the Banking Union and one national resolution authority within the Banking Union reported issuances under US law.
8	**Institutional investors are the main class of investors for MREL-eligible instruments but, in some cases, retail investors may be exposed**	Most resolution authorities suggested that institutional investors (investment funds, insurance companies, pension funds, other credit institutions, etc.) were the predominant type of investors holding MREL-eligible instruments. However, a few resolution authorities indicated significant exposure of retail investors to MREL instruments—in one instance, they were reported to hold almost half of Tier 1 and Tier 2 instruments. A few resolution authorities reported subordinated debt instruments issued to parent institutions.
9	**Besides a few established capital markets, most domestic capital markets for MREL instruments are relatively small**	Most of the domestic markets were described to be of limited size and liquidity. However, resolution authorities found it difficult to assess potential market capacity. One resolution authority suggested that the largest European financial institutions (e.g. G-SIBs) had access to international markets, but such access was a challenge for O-SIIs. A few resolution authorities suggested that there was limited or no access to international financial markets for deposit-funded banks.
10	**Split views regarding the policy approach to treating deposits as MREL-eligible liabilities**	There were split views among resolution authorities on treating non-preferred medium-term deposits as liabilities eligible for MREL. Some preferred to exclude deposits due to their limited loss-absorbing capacity in resolution, and to avoid spillover effects or unintended systemic consequences. Others suggested that deposit-funded institutions with limited access to capital markets would still have to rely on eligible deposits (beyond CET1 instruments) to meet MREL requirements.

3. Quantitative analysis

The EBA has analysed data on a large and diverse sample of banks in order to assess the situation of banks operating in the EU in relation to different scenarios for the calibration of the MREL requirements and to consider different options for the scope of MREL-eligible instruments. In no manner should the funding needs described in this report be interpreted as an indication of compliance or non-compliance by European banks with MREL requirements, as these requirements are yet to be determined and will only be phased-in progressively.

3.1 Sample

This report draws on data on external MREL issuance collected through the EBA's regular CRD – CRR/Basel III monitoring exercise[28] as of December 2015.

The sample comprises 133 banks from 18 EU Member States and covers approximately two thirds of the total EU banking sector's assets.[29]

The sample includes almost all EU G-SIBs[30] and a fair proportion of EU O-SIIs.[31] The sample also includes banks that are neither G-SIBs nor O-SIIs, referred to as 'other banks'. For the present analysis, the sample of O-SIIs excludes G-SIBs.

For analytical purposes, banks in the sample are broken down into two groups based on size and cross-border activity: Group 1 banks that have Tier 1 capital in excess of EUR 3 billion and are internationally active, and Group 2 banks (the remaining banks).

Banks are further split into large (with Tier 1 capital in excess of or equal to EUR 3 billion), medium (with Tier 1 capital below EUR 3 billion and above or equal to EUR 1.5 billion), and small (with Tier 1 capital below EUR 1.5 billion).

More than two thirds of the banks in the sample have Tier 1 capital below EUR 3 billion or are active only domestically. Of those, almost half are small banks with Tier 1 capital below EUR 1.5 billion. Beyond the classification of banks into Group 1 and Group 2, the subsamples remain very diverse in terms of banks' TLOF, with Group 1 banks' TLOF ranging between EUR 24 billion and EUR 2 181 billion and Group 2 banks' TLOF ranging between EUR 0.7 billion and EUR 305 billion.

[28] For more information on the EBA's Basel II monitoring exercise, see https://www.eba.europa.eu/risk-analysis-and-data/quantitative-impact-study/basel-iii-monitoring-exercise.

[29] Data source: ECB Consolidated Banking Data database.

[30] Except one G-SIB in the United Kingdom.

[31] Defined in accordance with respective lists published on the EBA's website (https://www.eba.europa.eu/risk-analysis-and-data/other-systemically-important-institutions-o-siis-/2015).

Table 2: Number of banks split by systemic importance, size and international activity, per Member State

	Total	*Of which G-SIBs*	*Of which O-SIIs*				*Of which other banks*			
			Group 1	*Group 2 large*	*Group 2 medium*	*Group 2 small*	*Group 1*	*Group 2 large*	*Group 2 medium*	*Group 2 small*
Austria	7	—	3	1	1	—	—	—	—	2
Belgium	4	—	2	—	1	—	—	—	—	1
Denmark	4	—	1	2	—	1	—	—	—	—
France	7	4	1	1	—	—	—	—	—	1
Germany	31	1	5	3	—	—	—	3	4	15
Greece	4	—	4	—	—	—	—	—	—	—
Hungary	2	—	1	—	—	—	—	—	—	1
Ireland	4	—	2	—	—	—	1	—	1	—
Italy	25	1	1	1	—	—	—	5	9	8
Luxembourg	3	—	—	—	2	—	—	—	—	1
Malta	3	—	—	—	—	2	—	—	—	1
Netherlands	6	1	2	1	1	—	—	—	—	1
Poland	5	—	—	—	—	—	—	1	—	4
Portugal	3	—	2	—	1	—	—	—	—	—
Slovakia	1	—	—	—	—	1	—	—	—	—
Spain	11	1	1	4	—	—	—	3	2	—
Sweden	8	1	3	—	—	—	—	—	1	3
United Kingdom	5	3	1	1	—	—	—	—	—	—
Total	**133**	**12**	**29**	**14**	**6**	**4**	**1**	**12**	**17**	**38**

The sample decomposition per funding model reveals that 53 banks rely significantly on retail deposit funding. If further classified by business model,[32] most banks in the sample are either universal banks or retail/commercial banks.

[32] In accordance with the methodology of the BCBS Policy Development Group developed for the purpose of leverage ratio analysis (eight business models).

Table 3: Number of banks, differentiated by funding model and business model, per Member State

	Funding models		*Business models*[33]	
	Mainly retail deposit-funded banks[34]	*Other banks*	*Universal banking*	*Retail/commercial banking*
Austria	2	5	4	3
Belgium	3	1	2	2
Denmark	1	3	3	—
France	1	6	5	1
Germany	11	20	11	18
Greece	1	3	—	4
Hungary	1	1	2	—
Ireland	3	1	—	4
Italy	10	15	3	22
Luxembourg	—	3	3	—
Malta	3	—	—	2
Netherlands	2	4	4	1
Poland	4	1	5	—
Portugal	3	—	3	—
Slovakia	—	1	1	—
Spain	6	5	6	5
Sweden	—	8	8	—
United Kingdom	2	3	4	1
Total	**53**	**80**	**64**	**63**

3.2 Estimates of MREL ratios, composition and funding needs

3.2.1 Methodology and limitations

At the time of publication, the policy approach that resolution authorities in the EU will adopt when implementing the MREL requirement has only been partially clarified[35] and no MREL decisions have been taken. As a result, assumptions had to be made on MREL calibration scenarios (i.e. what level of loss-absorbing amounts and RCAs would be determined by resolution authorities) and these are inevitably only proxies for the bank-specific, and currently unknown

[33] A few banks are not classified or classified into different business model categories.

[34] This is defined as banks with at least 40% of TLOF composed of retail deposits.

[35] The Bank of England published its final policy statement on 8 November 2016. Following a consultation started in April 2016, the Swedish National Debt Office (SNDO) has announced that further information will be provided at the start of 2017.

resolution strategies that will be decided. Regarding the scope of MREL-eligible instruments, a limited number of policy options have been considered.

Important data analysis caveats

A number of data analysis caveats (summarised in Table 4) should be also taken into account when interpreting the results of the MREL funding needs analysis.

Table 4: Data analysis caveats

No	Issue	Explanation
1	**MREL calculation methodology**	MREL is calculated on a consolidated level. This is also pragmatic in the first phase of MREL determination, since, at this point in time, resolution authorities intend to set MREL at a consolidated level first. It must be noted that, for G-SIBs, the TLAC term sheet sets requirements in terms of resolution entities.
2	**Sample composition (small banks)**	Despite a relatively high number of small banks included in the December 2015 sample, the assessed impact may only be seen as a rather imperfect proxy for the real impact on all small banks due to the significant diversity in the sector.
3	**Definition of small banks**	'Small banks' are defined in the analysis as institutions with Tier 1 capital below EUR 1.5 billion. This threshold may be relatively high in certain Member States.
4	**Static balance sheet assumption**	For the purpose of the analysis, a static balance sheet approach has been used—i.e. it is assumed that the entity after resolution would have the same size and risks as prior to the resolution. This is a strong assumption, as banks may end up being smaller entities following resolution. As such, this assumption is an imperfect proxy for some resolution tools.
5	**No MREL decisions**	As of December 2016, three resolution authorities have consulted on their MREL policies and one of them has finalised its MREL policy. However, no MREL decision has been made. Against this backdrop, to calibrate MREL requirements a number of assumptions had to be made on the scope of eligible liabilities to be included in MREL and on likely scenarios.

Scenarios regarding the calibration of MREL

It is not possible, at this stage, to determine with certainty how much TLOF institutions would need to meet their MREL requirement because, as previously mentioned, this will depend on actual bank-specific MREL decisions by resolution authorities (which have not yet been taken). However, to obtain a view of the magnitude of possible needs, two MREL calibration scenarios were considered taking into account the provisions of the BRRD and the RTS on MREL, as well as the draft and final policies communicated by a few resolution authorities:

➔ An **LA buffer scenario** – Twice capital requirements + CBR, i.e. **[2 x (P1 + P2) + CBR]**. Buffers are not included in the RCA. No market confidence layer is considered.

➔ A **buffer/8% scenario** – Higher of twice capital requirements including the CBR, and 8% of TLOF, i.e. [max {2 x (P1 + P2 + CBR); 8% of TLOF}]. When calculating the RCA, the scenario assumes that the resolution authority includes the CBR and also assesses, for all banks, the potential impact of the requirement for burden sharing to be imposed on at least 8% of an institution's TLOF in order to ensure access to resolution financing arrangements. This could be required to implement the resolution scheme. This scenario cannot be assumed to be a likely outcome for all banks in the sample.

In addition, MREL calibration scenarios do not take into account the upcoming leverage ratio requirement, which resolution authorities will have to take into account when setting the MREL requirement.
Table 5 below provides an overview of the two aforementioned scenarios for MREL calibration.

Table 5: Assumptions regarding the calibration of MREL

Scenarios	Threshold denomination	Explanation of threshold
LA buffer	Capital requirements (including Pillar 2) without considering buffers for the RCA	**Minimum MREL = Loss absorption + Recapitalisation** • Loss absorption = Pillar 1 (8%) + Pillar 2[36] + CBR[37] • Recapitalisation = Pillar 1 (8%) + Pillar 2
Buffer/8%	Higher of twice capital requirements (including buffers) and 8% of TLOF	**Minimum MREL** = Max {TLOF * 8%; 2 x (Pillar 1 (8%) + Pillar 2 + CBR)

Scope of MREL-eligible instruments

Two different options have been considered in terms of the scope of instruments eligible for MREL:

➔ **Current MREL** (MREL) covers all currently MREL-eligible instruments[38]—i.e. without excluding MREL-eligible deposits not covered by DGSs (i.e. deposits with a residual maturity of more than 1 year). Deposits might possibly be excluded from MREL if resolution authorities consider this necessary to maintain the critical functions of the resolved institutions or to avoid contagion. Structured notes are considered to be MREL eligible;

➔ **Current MREL excluding deposits** (MREL ex dep) excludes all deposits, even if they are MREL-eligible (i.e. 'blanket' deposit exemption).

[36] The Pillar 2 component of the capital requirement is a bank-specific number reduced by 1 percentage point (100 basis points (bps)) as a proxy to account for the existence of the Pillar 2 requirement and the Pillar 2 guidance in the 2016 SSM SREP methodology and decisions. The average Pillar 2 component of the sample after deducting 100 basis points is 1.4% of RWAs.

[37] The CBR is the sum of a capital conservation buffer set as 2.5%, any applicable countercyclical capital buffer and a systemic buffer that is a bank-specific number.

[38] As defined in Article 45(4) of the BRRD.

Table 6: Assumptions regarding the scope of eligible liabilities and the MREL ratio

MREL numerator	MREL definition	MREL ratio (calibration)
Current MREL (MREL)	Regulatory capital + Total unsecured subordinated debt > 1 year + Total senior unsecured debt > 1 year + MREL-eligible deposits > 1 year	Current MREL/TLOF[39]
Current MREL (excluding deposits) (MREL ex dep)	Regulatory capital + Total unsecured subordinated debt > 1 year + Total senior unsecured debt > 1 year	Current MREL (excluding deposits)/TLOF[40]

Additional alternative recapitalisation scenario for Group 2 and other banks

For some banks, and particularly for smaller ones, if liquidation is both feasible and credible then the required MREL RCA would be zero in principle.[41] For banks where resolution authorities assess that liquidation is not credible and feasible, and where the preferred resolution strategy considers that some assets and liabilities would be transferred, an RCA would be set at a lower level than what a full balance sheet recapitalisation would necessitate.

To illustrate the impact of such potentially lower MREL recapitalisation requirements, a variant of the LA buffer and the buffer/8% scenarios is also included. More precisely, for Group 2 (91 banks) and other banks (68 banks), additional analysis has been conducted assuming a 50% RCA instead of the full recapitalisation under the LA buffer and the buffer/8% scenarios. It should be noted that the Group 2 and other bank samples overlap to some extent, but both taxonomies have been used for illustrative purposes to show the difference in MREL needs for non-systemic banks and also for non-internationally active banks.

Table 7: Alternative scenario for Group 2 and other banks, variant of the LA buffer and the buffer/8% scenarios

Partial recapitalisation scenario	Variant of the LA buffer scenario	**Minimum MREL = Loss absorption + Recapitalisation x 50%** ▪ Loss absorption = Pillar 1 (8%) + Pillar 2 + CBR ▪ Recapitalisation x 50% = (Pillar 1 (8%) + Pillar 2) * 50%
	Variant of the Buffer/8% scenario	**Minimum MREL = Max {TLOF * 8%; Loss absorption + Recapitalisation x 50%}** ▪ Loss absorption = Pillar 1 (8%) + Pillar 2 + CBR ▪ Recapitalisation x 50% = (Pillar 1 (8%) + Pillar 2 + CBR) * 50%

[39] After full netting.

[40] After full netting.

[41] Unless, as per Article 2(2) of the RTS on MREL, the resolution authority determines that a positive amount is necessary on the grounds that liquidation would not achieve the resolution objectives to the same extent as an alternative resolution strategy.

Partial subordination requirement

In order to estimate the potential impact of a subordination requirement in relation to MREL, an assumption was made with respect to its perimeter and calibration (which is reflected in the policy recommendation on subordination made in this report):

Table 8: Partial subordination scenarios

Phase-in/subordination requirement for:	G-SIBs	O-SIIs[42]	Other
2019	13.5% of RWAs + CBR	N/A	N/A
2022	14.5% of RWAs + CBR	13.5% of RWAs + CBR	N/A

As a starting point, it is assumed that—as per the TLAC term sheet—G-SIBs will at least be subject to a subordination requirement of 14.5% of RWAs[43] (+ CBR).

In addition, with a view to assessing the impact of a potential recommendation to extend subordination beyond G-SIBs, the 'partial subordination' scenario also measures the impact of a subordination requirement of 13.5% of RWAs (+ CBR) for O-SIIs. The rationale for this hypothesis is described in Section 6.1 and summarised here: it is aimed at ensuring that MREL is readily available, limiting the risk of breaching the NCWO requirement, facilitating the task of the resolution authorities and ensuring a level playing field. A longer transitional phase-in period was assumed to acknowledge the different levels of preparedness of these banks (O-SIIs but not G-SIBs) to meet this 'new' requirement. This additional preparation may be needed to access the markets and eventually to build the required loss-absorbing capacity.

Finally, a number of assumptions regarding subordination were made. Due to the retroactive effect of the German statutory subordination law (which will enter into force on 1 January 2017), senior unsecured debt instruments[44] issued by banks in Germany have been treated as subordinated. Senior unsecured debt instruments issued from non-operating holding companies (HoldCos) in the United Kingdom have also been treated as subordinated.

Finally, in order to estimate the potential impact of a full subordination requirement in relation to MREL, analysis on an additional scenario has been carried out based on the assumption that the scope of instruments eligible for MREL would be limited to capital and subordinated debt only. However, this is not a likely scenario. The results obtained serve as a benchmark for MREL funding needs under the more likely partial subordination scenario.

[42] The entry into force of a partial subordination requirement for O-SIIs is assumed to be 2022 for the purposes of the quantitative analysis. However, in line with the recommendation made in Section 6 below, resolution authorities may set different transitional periods and/or a different calibration for this requirement on a case-by-case basis.

[43] G-SIBs would be required to meet their MREL with subordinated instruments, at least to a level of 16% of RWAs in 2019, 18% of RWAs in 2022, in line with the TLAC term sheet. Subordination would not be required to the extent that the amount of excluded liabilities that rank pari passu or junior to MREL-eligible liabilities does not exceed 5% of MREL-eligible instruments. As a result, resolution authorities should be able to set a subordination requirement for G-SIBs not lower than 13.5% of RWAs in 2019 and 14.5% of RWAs in 2022.

[44] With the exception of senior unsecured structured notes.

Cross-holdings of MREL debt instruments

To support a potential policy recommendation for the treatment of MREL cross-holdings, an overview of current MREL-eligible debt, including subordinated eligible liabilities, has been undertaken. Possible MREL financing needs under the partial subordination scenario after deducting subordinated MREL holdings have been estimated.

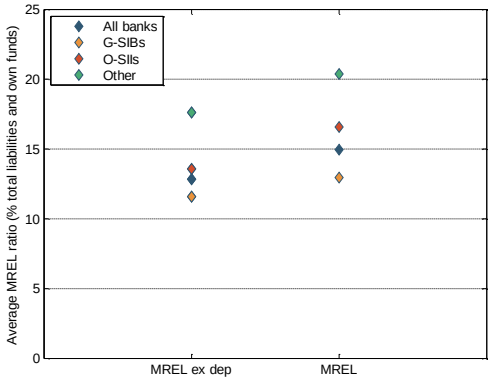
3.2.2 Estimates of MREL ratios & MREL funding needs under different scenarios

Average MREL ratios are high but heterogeneous across the sample, considering systemic importance, size, cross-border activity and funding profile

Based on the current MREL eligibility criteria, the average MREL ratio of a sample of 133 EU banks as of end December 2015 stands at approximately 15% of TLOF or 37.0% of RWAs. However, the results across the sample are heterogeneous (see Figure 3, Figure 4 and Figure 5). The results are further broken down on the basis of (1) systemic importance, (2) size and cross-border activity, and (3) funding profile.

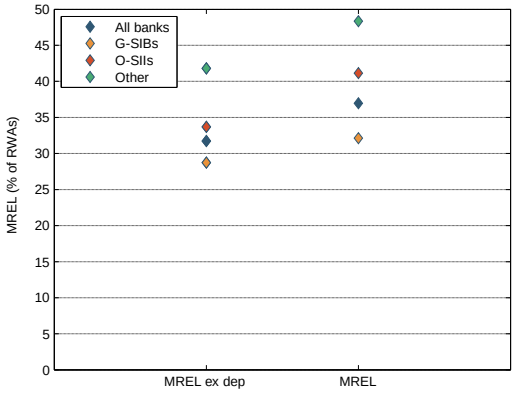
(1) The MREL ratio is slightly below average for G-SIBs (32.1% of RWAs), slightly above average for O-SIIs (41.2% of RWAs), and significantly higher (48.4% of RWAs) for the other remaining banks (non-G-SIBs and non-O-SIIs).

Figure 1: Average MREL ratio by systemic importance (% of TLOF)



Source: EBA QIS data (December 2015)

Figure 2: Average MREL ratio (% of RWAs)



Source: EBA QIS data (December 2015)

Figure 3: G-SIBs – MREL ratio in % of RWAs

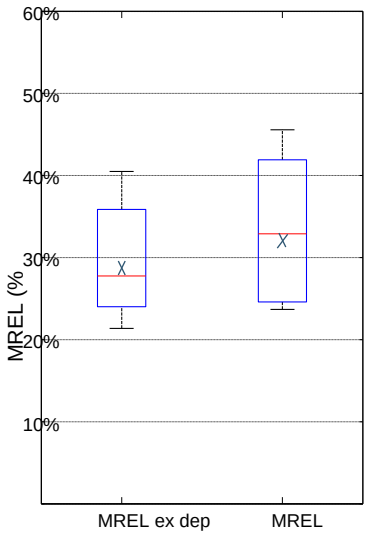


Figure 4: O-SIIs – MREL ratio in % of RWAs

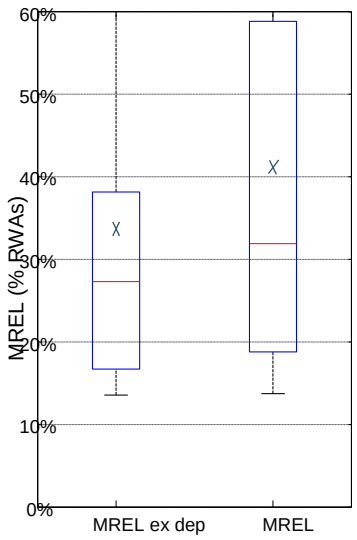
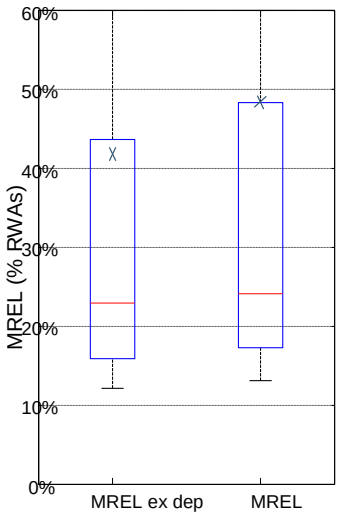


Figure 5: Other (non-G-SIB and non-O-SII) – MREL ratio in % of RWAs



Source: EBA QIS data (December 2015)

Table 9: Average MREL ratio by systemic importance

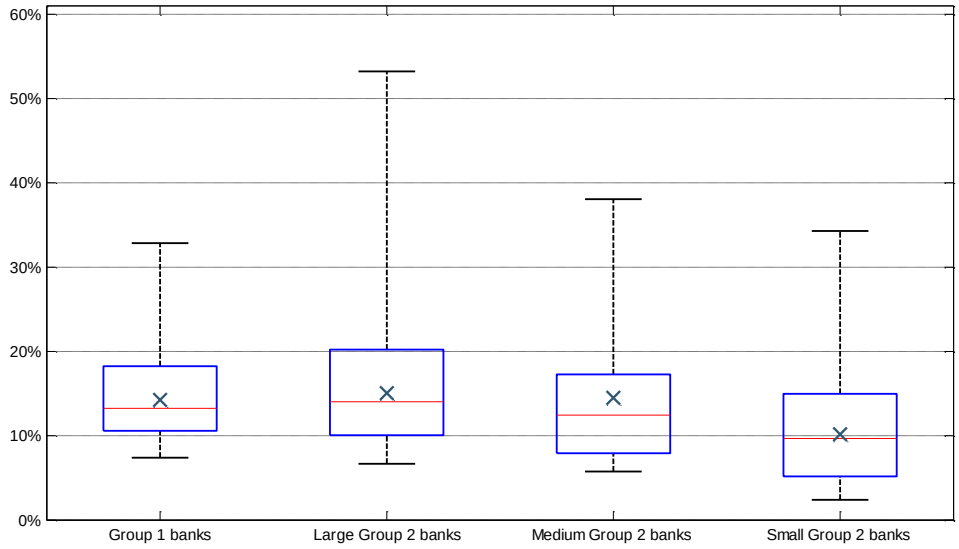
% of RWAs	All banks	G-SIBs	O-SIIs	Other
MREL	37.0	32.1	41.2	48.4
MREL ex dep	31.7	28.7	33.7	41.8

% of TLOF	All banks	G-SIBs	O-SIIs	Other
MREL	15.0	13.0	16.6	20.4
MREL ex dep	12.8	11.6	13.6	17.6

The average MREL ratio relative to TLOF falls by more than 2 percentage points if MREL-eligible deposits were to be excluded. The variability of results between bank groups is also reduced.

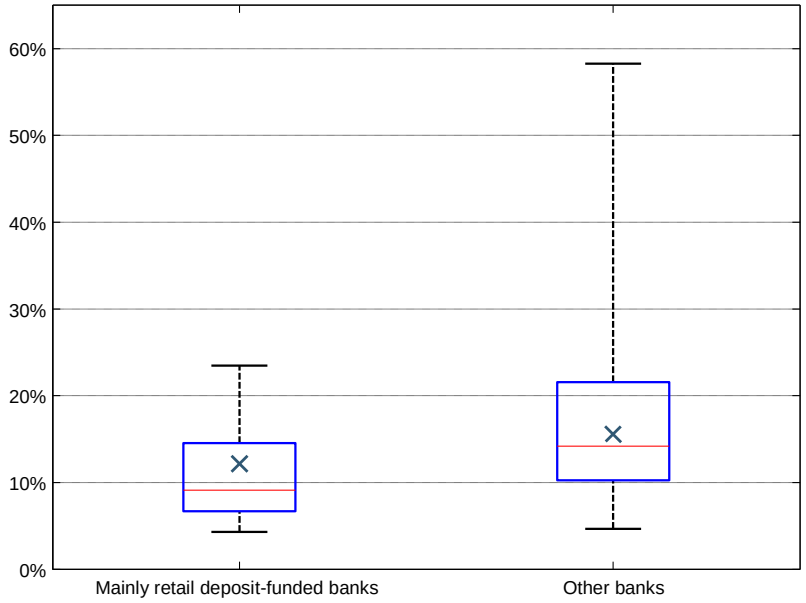
(2) Large and medium Group 2 banks show, on average, higher MREL ratios than Group 1 banks. It should be noted, however, that the variability across Group 2 banks is also very high, with the smallest banks showing below-average MREL ratios. For example, for half of the small Group 2 banks (more than 20 institutions), MREL ratios are below 10% of TLOF (20% of RWAs).

Figure 6: Distribution of MREL ratio[45] by size and cross-border activity (% of TLOF)



(3) Retail deposit-funded banks[46] have lower than average MREL ratios, with half of the banks in the sample exhibiting MREL ratios below 10% of TLOF.

Figure 7: Distribution of MREL ratio by reliance on deposits (% of TLOF)



Source: EBA QIS data (December 2015)

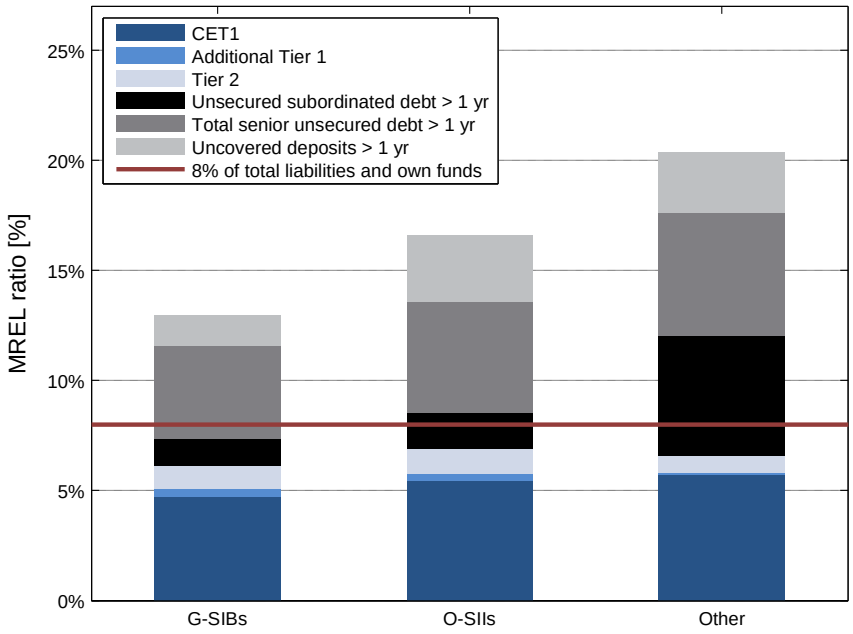
[45] The box-and-whisker plots contained in this section show the interquartile range (blue box), the 95th and 5th percentile, the median (red line) and 'x' average values of the distribution.

[46] Defined as banks with at least 40% of TLOF composed of retail deposits.

MREL composition

Analysis of the composition of MREL-eligible instruments reveals that capital instruments constitute the highest proportion of EU banks' MREL-eligible stack—on average, 43% of total MREL[47]. On average, other banks (non-G-SIBs and non-O-SIIs) have the highest proportion of subordinated debt, at approximately 5% of TLOF. O-SIIs have a lower proportion of subordinated debt than other banks and a higher proportion of MREL-eligible deposits than G-SIBs.

Figure 8: Composition[48] of MREL by banks' systemic importance (% of TLOF)



Source: EBA QIS data (December 2015)

MREL financing needs

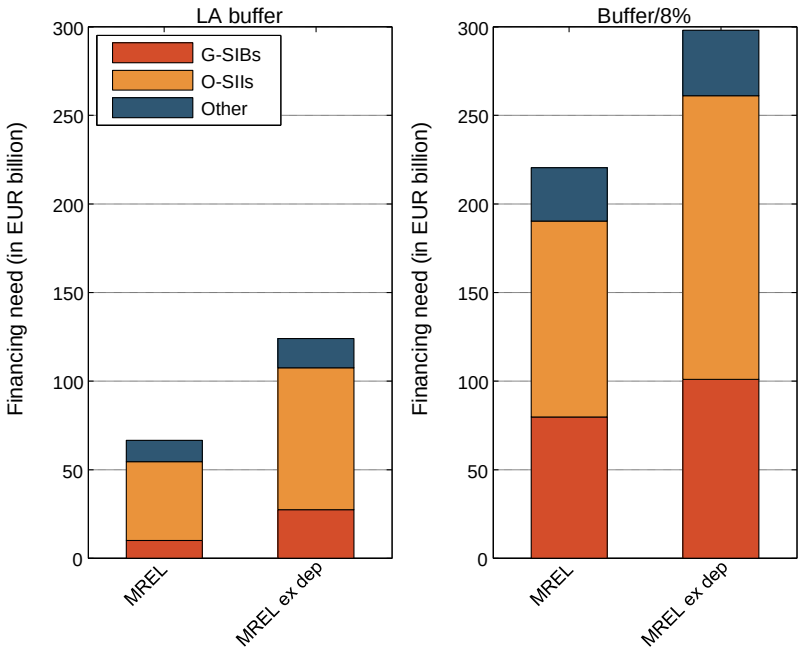
Overall financing needs and differences across banks

Based on the current MREL eligibility criteria and 'without subordination' requirement, the estimated MREL financing needs of the 133 EU banks in the EBA sample range from EUR 66.6 billion under the LA buffer calibration scenario to EUR 220.5 billion under the buffer/8% scenario. Financing needs would increase to EUR 123.9 billion and EUR 298.1 billion respectively if MREL-eligible deposits were excluded from the MREL stack.

[47] Subordinated debt instruments account for 12%, senior debt for 31%, and deposits account for 14% of MREL.

[48] Averages are calculated as the sum of the components divided by the sum of TLOF within a group.

Figure 9: Estimated financing needs under alternative scenarios and scopes by banks' systemic importance



Source: EBA QIS data (December 2015)

Table 10: Financing needs on the basis of two hypothetical scenarios[49] (in EUR billion)

	LA buffer				*Buffer/8%*			
	G-SIBs	*O-SIIs*	*Other*	***TOTAL***	*G-SIBs*	*O-SIIs*	*Other*	***TOTAL***
MREL	10.0	44.6	12.0	**66.6**	79.7	110.6	30.2	**220.5**
MREL ex dep	27.4	80.1	16.4	**123.9**	101.0	160.1	37.0	**298.1**

To illustrate the magnitude of the estimated MREL financing needs, Table 11 shows MREL financing needs as a percentage of TLOF and RWAs.

[49] These scenarios do not reflect the fact that a subordination requirement will be applied to G-SIBs and, potentially, to some other banks.

Table 11: Financing needs[50] (% of TLOF and % of RWAs)

	LA buffer				Buffer/8%			
	% of TLOF of whole sample	% of TLOF of banks that may not meet assumed MREL steady-state requirements	% of RWAs of whole sample	% of RWAs of banks that may not meet assumed MREL steady-state requirements	% of TLOF of whole sample	% of TLOF of banks that may not meet assumed MREL steady-state requirements	% of RWAs of whole sample	% of RWAs of banks that may not meet assumed MREL steady-state requirements
MREL	0.3	1.6	0.6	3.4	0.9	2.2	2.1	5.1
MREL ex dep	0.5	2.1	1.2	4.5	1.2	2.4	2.9	5.6

Source: EBA QIS data (December 2015)

While these figures reflect results obtained when applying identical scenarios for all banks, they would benefit from a differentiation from at least two perspectives:

- First, these scenarios do not reflect the fact that a systematic subordination requirement will be applied to G-SIBs and, depending on the outcome of the legislative review, may also be extended to some other banks (e.g. O-SIIs);
- Second, these scenarios are likely to be too conservative for other banks. Indeed, in that group, some banks are likely to be liquidated while others may not be subject to full recapitalisation.

For these reasons, a partial subordination scenario has been calibrated for G-SIBs and O-SIIs, and a specific assessment of financing needs for other banks and Group 2 banks under a partial (50%) recapitalisation scenario has been considered.

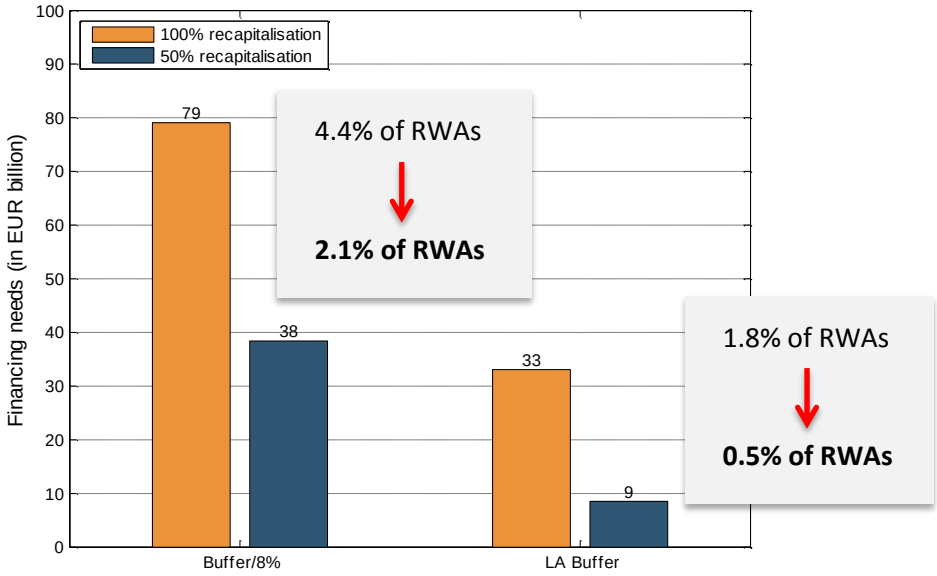
Impact on Group 2 and other banks (non-G-SIBs and non-O-SIIs) under the alternative recapitalisation scenario

Systemic importance and/or preferred resolution strategies will be key drivers in determining MREL requirements. Indeed, there will be no 'one size fits all' MREL calibration and both the loss absorption amount and the RCA will be tailor-made by resolution authorities for every bank.

As a result, the full recapitalisation scenario may not be applicable for all banks in the sample. To estimate the impact of potentially lower required RCAs (under variants of the MREL scenarios discussed, assuming a partial RCA of 50% and no subordination requirement), the MREL impact for Group 2 banks would decrease to EUR 9 billion and EUR 38 billion under the currently applicable MREL eligibility criteria. Estimated MREL funding needs would be significantly lower than the estimated amount of EUR 33 billion or EUR 79 billion under a full LA buffer or the buffer/8% recapitalisation scenarios respectively.

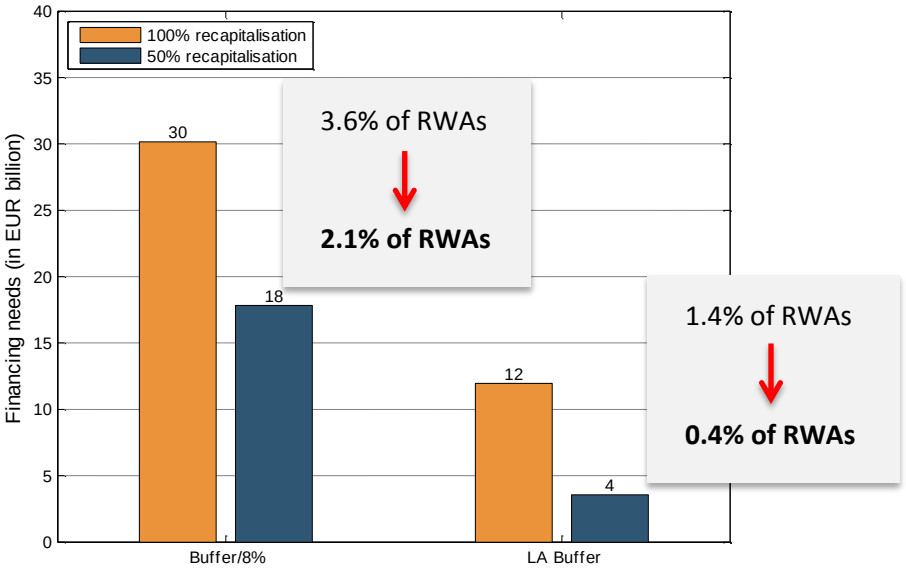
[50] These scenarios do not reflect the fact that a subordination requirement will be applied to G-SIBs and, potentially, to some other banks.

Figure 10: Estimated financing needs (in EUR billion) of Group 2 banks under variants of the MREL scenarios



As shown in the table above, assuming only partial recapitalisation for Group 2 banks would reduce the number of banks that may not meet assumed steady-state requirements by between one third and more than a half, depending on the calibration scenario. For those banks, MREL funding needs would decrease from 1.8% of RWAs (under the LA buffer) or 4.4% of RWAs (under the buffer/8% scenario) to **0.5% of RWAs and 2.1% of RWAs** respectively.

Figure 11: Estimated financing needs (in EUR billion) of other banks (non-G-SIBs and non-O-SIIs) under variants of the MREL scenarios



Similarly, when partial recapitalisation is assumed for other banks (non-G-SIBs and non-O-SIIs), estimated financing needs are reduced from between EUR 12 billion and EUR 30 billion to between EUR 3.6 billion and EUR 17.8 billion under the LA buffer or the buffer/8% scenarios. This is a significant reduction of around three quarters under the LA buffer calibration and around 40% under the buffer/8% calibration scenario. In relative terms, funding needs decrease from between 1.4% and 3.6% to between **0.4%** and **2.1%** of the concerned banks' RWAs under the LA buffer and

the buffer/8% scenarios respectively. This translates to 0.9% to 4.3% of the current MREL stack held by other banks.

Impact of a partial subordination requirement

To test the impact of subordination requirements on banks' MREL financing needs, a partial subordination requirement of 14.5% of RWAs + CBR for G-SIBs and 13.5% of RWAs + CBR for O-SIIs has been assessed.

Table 12: Estimated financing needs (in EUR billion; % of RWAs of the respective G-SIB/O-SII samples)

	LA buffer				*Buffer/8%*			
	Without subordination	*With partial subordination*			*Without subordination*	*With partial subordination*		
		Total	*Of which subordinated*	% of RWAs		*Total*	*Of which subordinated*	% of RWAs
G-SIBs	10.0	120.0	110.0	2.0%	79.7	140.3	110.0	2.0%
O-SIIs	44.6	62.5	44.4	1.1%	110.6	118.1	44.4	1.1%
*Other**	*3.6*	*3.6*			*17.8*	*17.8*		
Total	**58.2**	**186.1**	**154.4**	-	**208.1**	**276.2**	**154.4**	-

** **Other banks** (non-G-SIBs and non-O-SIIs): 50% partial recapitalisation scenario; no subordination assumption*

Source: EBA QIS data (December 2015)

The table below provides information how many banks may not meet assumed steady-state MREL requirements based on the assumed scenarios—the partial subordination scenario for G-SIBs and O-SIIs, and the partial recapitalisation scenario for other banks.

Table 13: Number of banks that may not meet assumed steady-state MREL requirements

	LA buffer		*Buffer/8%*	
	Without subordination	*With partial subordination*	*Without subordination*	*With partial subordination*
G-SIBs	1 out of 12	8 out of 12	4 out of 12	9 out of 12
O-SIIs	22 out of 53	30 out of 53	25 out of 53	32 out of 53
*Other**	*11 out of 68*	*11 out of 68*	*24 out of 68*	*24 out of 68*
Total	**34 out of 133**	**49 out of 133**	**53 out of 133**	**65 out of 133**

** **Other banks** (non-G-SIBs and non-O-SIIs): 50% partial recapitalisation scenario; no subordination assumption*

Source: EBA QIS data (December 2015)

The findings in Table 12 suggest that **total estimated financing needs** would **increase by EUR 127.9 billion** (from EUR 58.2 billion to EUR 186.1 billion) **under the LA buffer scenario**, and **by EUR 68.1 billion** (from EUR 208.1 billion to EUR 276.2 billion) **under the buffer/8% scenario**. The increase in total MREL financing needs in subordinated debt is the same under both scenarios—i.e. EUR 154.4 billion.

Figure 12: Increase in MREL financing needs (in EUR billion; under the LA buffer scenario)

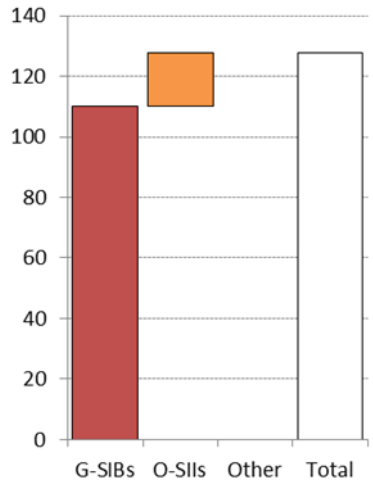
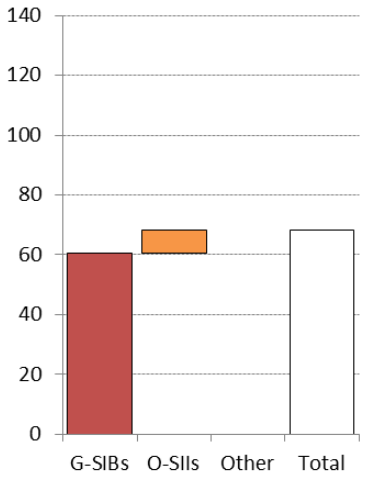


Figure 13: Increase in MREL financing needs (in EUR billion; under the buffer/8% scenario)



With regard to the different types of banks, under the **LA buffer scenario**, a partial subordination requirement increases total MREL financing needs by the most for G-SIBs—i.e. by EUR 110 billion (from EUR 10 billion to EUR 120 billion)—and EUR 110 billion is to be met with subordinated instruments. MREL financing needs for O-SIIs increase by EUR 17.9 billion (from EUR 44.6 billion to EUR 62.5 billion) and EUR 44.4 billion needs are to be met by subordinated MREL-eligible instruments. As no subordination requirement is assumed for other banks, the MREL financing needs for them do not change.

Under the buffer/8% scenario, a partial subordination requirement increases total MREL financing needs again by the most for G-SIBs, by EUR 60.6 billion (from EUR 79.7 billion to EUR 140.3 billion). MREL financing needs for O-SIIs increase by EUR 7.5 billion (from EUR 110.6 billion to EUR 118.1 billion). MREL funding needs in subordinated debt for G-SIBs and O-SIIs are the same as in the previous scenario.

The graphs below demonstrate the potential impact of a partial subordination requirement for O-SIIs and other banks based on various levels of the subordination requirement threshold. The dotted red line indicates the proposed 13.5% subordination requirement threshold and illustrates the additional MREL funding needs and the number of banks that would, as a result, meet the assumed MREL calibration.

G-SIBs are excluded from the analysis, as they are expected to be required to meet their MREL with subordinated instruments, at least to a level of 13.5% of RWAs in 2019 and 14.5% of RWAs in 2022 (as per the implementation of the TLAC term sheet in the EU legislation).

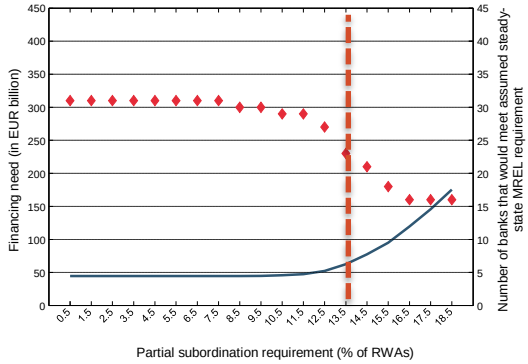
O-SIIs (partial subordination scenario)

Figure 14: Estimated financing needs (in EUR billion, left axis, blue line) and number of banks that would meet assumed steady-state MREL requirement (right axis, red diamonds)

Other banks (partial subordination scenario)

Figure 15: Estimated financing needs (in EUR billion, left axis, blue line) and number of banks that would meet assumed steady-state MREL requirement (right axis, red diamonds)

LA buffer



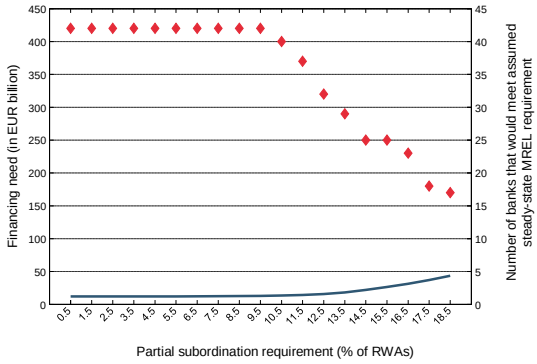
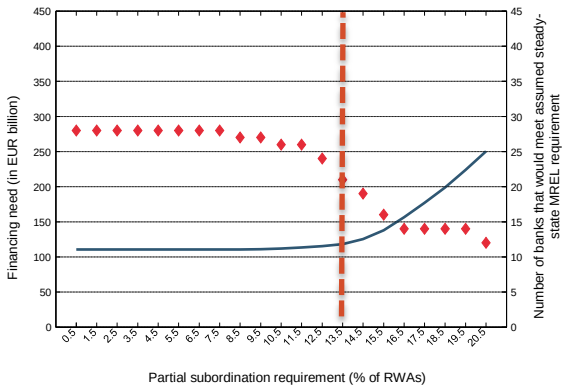
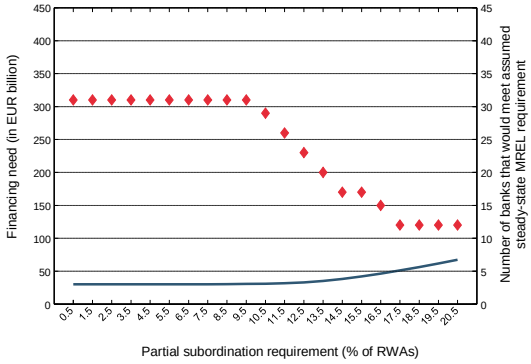


Figure 16: Estimated financing needs (in EUR billion, left axis, blue line) and number of banks that would meet assumed steady-state MREL requirement (right axis, red diamonds)

Figure 17: Estimated financing needs (in EUR billion, left axis, blue line) and number of banks that would meet assumed steady-state MREL requirement (right axis, red diamonds)

Buffer/8%





MREL funding needs under the full subordination scenario

It is realistic to expect that some banks will be subject to systematic subordination requirements and that some will not be subject to a full recapitalisation or may be liquidated.

Under a hypothetical full subordination scenario, MREL funding needs would be equal to between EUR 530.9 billion and EUR 908 billion under the LA buffer or the buffer/8% calibration scenarios. However, the full subordination scenario is not considered to be a likely outcome and results provided are for illustrative purposes only.

Table 14: Estimated financing needs in EUR billion and in % of RWAs of the relevant sample

	LA buffer			*Buffer/8%*		
	G-SIBs	*O-SIIs*	*Other*	*G-SIBs*	*O-SIIs*	*Other*
Own funds + subordinated debt (in EUR billion)	291.3	197.2	42.4	496.0	339.0	73.0
Own funds and subordinated debt (in % of RWAs)	5.3	4.9	5.0	9.0	8.5	8.6

3.3 Macroeconomic impact analysis

Article 45(20) of the BRRD calls on the EBA to take into account (in its MREL report) the impact of MREL on a wide range of elements, including financial markets, profitability and costs of funding, financial innovation and the level of lending.

This chapter outlines the key assumptions and limitations of the methodology used to assess the macroeconomic costs and benefits of the MREL regime for banks and the economy in general. It also discusses the main findings and overall impact.

!	The actual impact of MREL will depend on **the capacity of markets to absorb the volumes of MREL issuances** needed for the build-up of MREL and the corresponding **capacity of banks** (especially deposit-funded banks) **to access markets**, including access to deep, developed markets. At this stage, MREL market capacity is uncertain in a number of EU jurisdictions and the evolution in the coming years cannot be adequately assessed. As a result, the MREL macroeconomic impact can only be estimated by making certain assumptions regarding funding costs, steady-state MREL targets and MREL market capacity. For the purposes of this analysis, full market capacity has been assumed, potentially underestimating the actual effect on the cost of funding.

3.3.1 Methodology and limitations

The MREL benefit analysis is based on a static accounting approach. It uses the findings and approaches of similar impact assessments, in which the benefit stems from a lower probability of crisis and—in case a crisis does occur—a reduced cost of such an event in terms of gross domestic product (GDP). Without having quantified important qualitative aspects that converge/contribute to highlighting the benefits of MREL, a simplified 'accounting-like' approach is used to quantify the benefits of introducing the MREL tool.

The cost analysis assesses the impact of MREL financing needs and the resulting incremental costs for banks in terms of the reduction of GDP. In order to meet MREL funding needs, banks would need to issue new debt that is more costly than their current non-eligible liabilities. All other things being equal, the higher cost of MREL-eligible debt will result in lower returns on equity or—at equal return on equity (ROE)—will result in increased lending spreads. These lending spread increases could, in turn, exert negative pressure on output as the costs of financing non-financial corporations and households increase. The macroeconomic costs are obtained by means of accounting-based calculations to derive incremental lending spread increases. Incremental lending spread increases are then plotted on a suite of macroeconomic models to estimate potential real GDP implications.

a) Limitations

The caveats provided in the following table and further developed in this subsection should be carefully assessed and taken into account when interpreting the results of the MREL impact assessment.

Table 15: Limitations of the MREL cost-benefit assessment methodology

	Topic	Main caveats
1	**At this stage, it is not possible to estimate the impact of MREL on market capacity and pricing**	**It is assumed that all banks can issue new appropriately priced MREL instruments**. In practice, the potential crowding out effect cannot be disregarded for some institutions. It was not possible to determine the exact funding costs for individual banks in different Member States, as this would require judgemental assumptions about jurisdiction-specific market capacity in a multi-year period. Market capacity and funding costs may vary significantly depending on the banking sector, bank size and business model.
2	**There are limitations with regard to the estimation of MREL benefits**	A number of judgemental assumptions were made to estimate MREL benefits. The benefits may vary across EU economies.
3	**Funding costs and assumed increases in lending spreads are not calculated at bank level**	An aggregate funding cost increase in a Member State is translated into higher lending rates and, subsequently, into a GDP reduction. This may underestimate or overestimate the impact on individual banks.
4	**Credit ratings are not available for all banks and all instruments; hence the estimated increase in funding costs can only be approximated**	The cost of senior debt is estimated based on long-term credit ratings. However, such ratings are not available for all banks in the sample. The pricing of subordinated debt can only be assumed based on available market information for larger banks, which may not be applicable to all banks in all Member States. A conservative funding cost assumption for senior debt priced at the cost of equity is made for all other banks and O-SIIs in Member States that have recently experienced severe financial and economic shocks and had to undergo financial assistance programmes as a result. Other factors—e.g. the financial situation of the bank or global risk factors—have not been taken into account.
5	**The macroeconomic models applied in the impact assessment have not been tailor-made for the MREL impact assessment**	The dynamic stochastic general equilibrium macroeconomic models applied in the impact assessment have not been tailor-made for the MREL impact assessment. Nevertheless, they were used in previous BCBS/FSB macroeconomic impact studies on regulatory reforms. Macroeconomic models have been calibrated for the euro area as a whole and therefore may not be suitable for country-specific simulations.
6	**Estimation of MREL funding needs and related funding costs**	Actual MREL funding needs and related funding costs may be materially different than assumed in the report, which could, in turn, result in changes in the macroeconomic net benefits.

1 At this stage, it is not possible to estimate the impact of MREL on market capacity and pricing

It is assumed that there is a full market capacity to absorb any required issuance of MREL instruments. However, that may not be the case for all banks in all Member States—for example, in countries with less developed capital markets or for certain types of banks (e.g. smaller deposit-funded banks). To test this assumption, it would require judgmental assumptions about jurisdiction-specific market capacity in a multi-year period. In addition, market capacity and funding costs may vary significantly depending on funding needs resulting from actual MREL calibration scenarios, the banking sector, the bank's size and its business model. While the sample of banks used for the data analysis is representative of a large part of the EU banking sector (including small to mid-sized banks), the smallest institutions may not have been captured.

2 There are limitations with regard to the estimation of MREL benefits

The assessment of MREL benefits is driven by a number of different underlying assumptions in many dimensions. In particular, it is driven by assumptions on: i) the probability of a crisis event, ii) the decrease in the probability of a crisis event, iii) the reduction in the cost of a financial crisis due to MREL, iv) the initial GDP decline in case of a crisis, v) the time horizon for which GDP output loss is temporary, vi) the magnitude of permanent GDP loss, vii) the applicable discount rate, and so on. All those inputs had to be assumed based on the findings of similar impact assessments and available research. In reality, Member States' economies may be more or less receptive to positive and negative shocks depending on their macroeconomic circumstances; therefore, the positive impact of MREL may be different.

3 MREL funding costs and assumed increases in lending spreads are not calculated at bank level

Instead of using bank-specific data, an aggregate funding cost increase in a Member State is translated into higher lending rates and, subsequently, into a GDP reduction. This simplification only provides an approximate quantification of the impact of MREL and ignores the likely heterogeneous effects across the sample of banks and the banking sector in which they operate, which can be widely ranged. For instance, it cannot be excluded that the funding cost increase related to substituting non-eligible with eligible liabilities would be higher for smaller deposit-funded institutions than for systemic institutions. At the same time, if (for some banks) the share of net interest income compared to other income sources were higher, the pressure to increase loan rates would be reduced.

4 Credit ratings are not available for all banks and all instruments; hence the estimated increase in funding costs can only be approximated

To assess the differences in funding costs across Member States and the systemic importance of banks, the cost of senior debt is estimated based on banks' long-term credit ratings.[51] However, credit ratings are not available for all banks and instruments in the sample. To determine the subordinated debt spread over senior unsecured debt an analysis of historical spread developments of senior unsecured debt issued by a selection of HoldCos and operating subsidiaries (OpCos) in the United Kingdom and an analysis of the senior unsecured and subordinated debt spread after the announcement of TLAC/MREL proposals and the German

[51] Data source: SNL Financial, Standard and Poor's (S&P), Moody's, and Fitch Ratings. Long-term credit ratings for the European Banking sector are used to calculate weighted average ratings for Member States.

law[52] to subordinate senior unsecured debt are used. This assumption may apply for G-SIBs, but it may not necessarily be a relevant proxy for funding costs to be incurred by all banks in all Member States. For O-SIIs, a subordinated debt spread is estimated as the difference between financial institutions' senior and subordinated debt indices,[53] with the exception of O-SIIs in Member States that have received financial assistance. For such entities, as well as for other (non-G-SIBs and non-O-SIIs) banks, the funding cost is assumed to be equal to the cost of equity. The calculation of spreads between subordinated and senior issuances may fall short of capturing the long-run subordination premium. Other factors, such as the current financial situation of the bank or domestic and global risk factors, are not taken into account; this could also be an important limitation.

5 The dynamic stochastic general equilibrium macroeconomic models applied in the impact assessment have not been tailor-made for the MREL impact assessment

The macroeconomic models used may not be ideally suited for the exercise. It should also be kept in mind that the macroeconomic models have been estimated (or, in some cases, calibrated) for the euro area as a whole and therefore do not necessarily lend themselves well to country-specific simulations. Moreover, there are a number of caveats surrounding the certainty with which the results should be interpreted. Indeed, for a number of reasons, the overall results may either be upward or downward biased.

Some biases that may lead to an **overestimation** of the impact are as follows. First, the modelling input (in terms of higher lending spreads) is not conditioned on business cycle fluctuations or monetary policy actions that may exacerbate or alleviate the derived need for banks to adjust their balance sheets in response to the new MREL requirements. For instance, positive real GDP growth over the projection horizon would be expected to somewhat alleviate the negative implications of the reform-induced increase in bank lending spreads (via its impact on bank earnings). Second, in most of the applied models, all firms are assumed to be credit constrained and bank-dependent. In reality, some firms might not be credit constrained, and bank loans can be at least partially substituted with other means of external finance.

Biases that may lead to an **underestimation** of the impact are as follows. First, the impact assessment of the increase in lending spreads and, in turn, on output does not take into account the potential distributional effects across different types of borrowers. If, for example, a resulting loan contraction mainly affects bank-dependent borrowers (such as retail customers and SMEs), the real economic impact might be exacerbated. Second, it is important to note that the results only refer to the long-run impact on output, whereas the macroeconomic implications of the transition to the new regulatory environment are not accounted for. Indeed, the transitional costs could be non-negligible, particularly in an environment of relatively weak economic growth and considerable financial market uncertainty.

[52] Effective as of January 2017.

[53] The 5-year Markit iTraxx Europe Senior Financial index and the 5-year Markit iTraxx Europe Subordinated Financial index.

Comparison of the methodology used in other impact assessments

The proposed methodology for conducting MREL macroeconomic impact assessments and the one used in the FSB TLAC paper share the same rationale regarding computing both costs and benefits.

In particular, a similar approach is followed by:

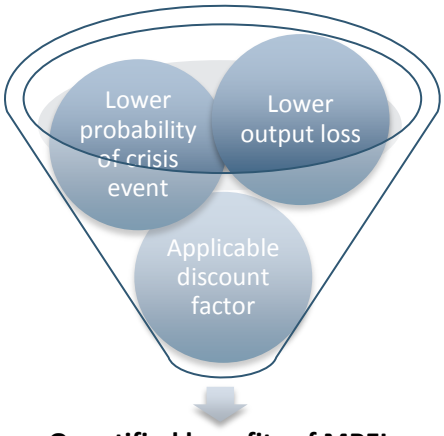
i) Translating the microeconomic impact of higher costs of credit for credit institutions' clients into lower levels of annual GDP;
i) assessing the decrease of the likelihood of systemic crises and government bail-outs, leading to expected benefits expressed as a percentage of GDP.

The main differences between the two methodologies could be summarised in the following points:

- The FSB TLAC paper uses the sample of G-SIBs, while the MREL impact assessment uses aggregated EU banking sector and macroeconomic figures (e.g. assets, RWAs, GDP, etc.);
- The FSB TLAC paper analyses global spillovers, while the MREL methodology does not conduct such an analysis, as it considers the EU a single economy with a single banking sector;
- The FSB TLAC paper calculates a range of benefit estimates under certain assumptions (e.g. on cost level, permanent effects), while the MREL methodology provides a range of MREL benefits based on certain simplified assumptions (e.g. initial output loss, time horizon of loss, share of permanent loss, applicable discount factor, etc.);
- The FSB TLAC impact assessment assumes that an increase in the funding cost of G-SIBs is translated into economy-wide costs by determining the corresponding increase in the lending rates that would be necessary to keep G-SIBs' net interest income (and therefore ROE) constant, producing (in this way) a range of potential outputs. The methodology for MREL—which is based on certain assumptions (e.g. given amounts for the EU banking sector's total assets, RWAs, additional capital required and the issuance or refinancing of MREL-eligible liabilities)—calculates the increase in lending spreads in a similarly simplified 'accounting-like' approach.

b) Methodology for assessing macroeconomic benefits

The benefits of introducing an MREL requirement should not be understated, especially as a safeguard for financial stability. MREL is expected to contribute to the enhancement of the banking system's resilience. The orderly resolution of a failing bank would increase market confidence and minimise negative systemic repercussions, as well as minimise the need for taxpayer bail-outs by internalising, to a large extent, the cost of failure.



Quantified benefits of MREL

In this context, a substantial part of the benefits of introducing MREL cannot easily be quantified. Nevertheless, the report—having benefited from the existing literature—quantifies the likely positive impact of the new regulatory requirement on GDP as a result of a reduced probability of a systemic crisis taking place, and a lower impact of any systemic crisis that does occur.

In short, the output loss per crisis can be calculated[54] by making assumptions on:

(i) The *initial output loss* in the case of a systemic crisis;

(ii) Decomposition between temporary and permanent impact on GDP;

(iii) An applicable *discount rate*.

Assuming the probability of a crisis, the expected output loss can be calculated when there is no MREL and compared to the expected cost with MREL in place. The latter would be smaller due to lower impact, cost of crisis and probability of a crisis.

Some small Members States' economies could be assumed to be more sensitive to negative systemic crisis shocks and—conditional on the crisis occurring—face a higher cumulative negative impact on GDP, with a higher permanent effect. As a corollary, the reduced likelihood and severity of systemic crises brought about by the introduction of MREL could also result in higher benefits for those Member States' economies. In this vein, it has been assumed in this report that Member States' economies that (in the context of the recent financial crisis) had to seek financial assistance from the EU (Cyprus, Greece, Ireland and Portugal) were and are, for the purpose of this analysis, more sensitive to negative systemic shocks. This, in turn, implies higher estimates of MREL benefits (Table 16). Equally, in order not to overestimate MREL benefits and to acknowledge that market conditions and the capacity for banks in those Member States may be more restrictive, stricter assumptions have been made in terms of issuance costs (Table 17).

[54] There are more assumptions (see below) covering aspects such as the probability of a crisis, time horizon of the crisis and level of risk reduction from MREL among others. At the same time, the analysis with regard to G-SIBs is less granular than in the impact assessment undertaken by BIS (2015).

Table 16: Stylised assumptions for the assessment of MREL benefits

	Probability of crisis	Probability of crisis reduction	Cost reduction (cumulative)	Initial GDP drop	Crisis time horizon	Permanent impact on GDP	Discount rate
All Member States	1%-2.3%	33%	5.4%	8%	3-5 years	25%	2.5%-5%
Member States that had to seek **financial assistance**	2.3%	33%	11%	10%	3-5 years	50%	2.5%

c) Methodology for assessing macroeconomic costs

The approach to estimate the macroeconomic costs of MREL follows the same logic as the economic impact assessment of TLAC prepared by the FSB expert group in 2015.[55] It relies on the following steps:

The starting point of the MREL costs assessment is the estimated MREL funding needs as of December 2015 under the LA buffer and the buffer/8% scenarios. The partial subordination scenario is applied to G-SIBs and O-SIIs, while the partial recapitalisation scenario is used for other banks. The funding costs for filling the identified funding needs vary in order to reflect differences in issuance costs across different Member States and the different systemic importances of financial institutions (G-SIBs, O-SIIs and other banks). In addition, the funding costs may be higher in Member States that have recently experienced severe financial and economic shocks.

Table 17: Assumed funding costs to fill MREL funding needs

	G-SIBs	O-SIIs	Other
All Member States	Senior; subordinated (= senior + 65 bps)	Senior; subordinated (= senior + 133 bps)	Senior debt priced at the cost of equity (8%)
Member States that had to seek **financial assistance**	Senior; subordinated (= senior + 65 bps)	Senior and subordinated debt priced at the cost of equity (8%)	

The senior debt cost for G-SIBs is estimated based on the average weighted ratings of G-SIBs in a Member State, while the senior debt cost of funding for O-SIIs is estimated based on the average weighted ratings of all remaining banks (except G-SIBs). The senior debt cost of other banks is conservatively assumed to be equal to the cost of equity,[56] which could result from limited market access, the relatively small size of issuances, a lack of long-term credit ratings, or limited demand from investors. The cost of senior and subordinated debt in EU Member States that have received

[55] See Bank of International Settlements (BIS) (2015), 'Assessing the economic costs and benefits of TLAC implementation', Basel, November 2015.

[56] The cost of equity is estimated to be 8%. Source: ECB Economic Bulletin, Issue 1/2016 – Article. Link: https://www.ecb.europa.eu/pub/pdf/other/eb201601_article01.en.pdf#page=15.

financial assistance (Cyprus, Greece, Ireland and Portugal) is also assumed to be equal to the cost of equity[57].

In all other Member States, the subordinated debt funding costs of O-SIIs are obtained by adding a 133-bps spread to the cost of senior debt based on credit ratings. Subordinated debt costs for G-SIBs are based on senior debt pricing augmented by a 65-bps spread, as suggested by market pricing evidence observed on structurally subordinated debt pricing for United Kingdom banks. However, it is acknowledged that the spreads applied and ultimate funding costs used in the analysis may not be relevant to all banks in all Member States, and actual spreads will depend on both the institutions' abilities to access the market and market capacity to absorb new MREL instruments.

In order to increase the precision of the MREL cost assessment, the analysis assesses what amount of MREL subordinated funding needs G-SIBs and O-SIIs can meet by replacing maturing senior debt (rollover), and what amounts need to be met with new issuances. It is assumed that banks can roll over most of the excess senior liabilities above the calibrated MREL requirement, with the notable exclusion of MREL-eligible deposits and liabilities with a remaining maturity of more than 5 years. The remaining MREL funding needs are covered by expanding balance sheets and issuing fresh subordinated instruments at full costs.

For G-SIBs and O-SIIs, it is assumed that the part of their total MREL needs that is not required to be subordinated is met with new issuances of senior debt.

Other banks are assumed not to have the ability to exchange non-eligible liabilities with eligible liabilities at all, mainly because they are (to a large extent) deposit-funded. Thus, they have to meet all their MREL funding needs with new issuances, which both expand their balance sheets and increase their funding costs.[58]

Under these assumptions, the total increase in funding costs for the EU banking sector would amount to EUR 3.2 billion under the LA buffer and EUR 5.8 billion under the buffer/8% scenario.[59] Under the scenario of no increase of funding costs for O-SIIs in relation to the cost of equity in certain Member States that have received financial assistance, the corresponding figures are EUR 2.9 billion (LA buffer) and EUR 5 billion (buffer/8%).

The rise in funding costs is compared to the banks' net interest income, and the necessary increase in loan rates is derived by assuming that banks' ROE is kept constant.[60] This assumption does not consider that, due to the competitive environment, banks might not be able to transmit the increase in funding costs into higher loan rates or that the cost of capital could fall as a result

[57] It should be noted that banks in Ireland have successfully returned to the markets since the onset of the crisis and have issued a number of senior and subordinated debt instruments at levels significantly lower than their cost of equity. In 2014 and 2015 Irish banks issued such instruments with spreads of between 150 – 395 basis points over mid swaps.

[58] The second and third assumptions may overestimate the costs somewhat, as at least part of the shortfall could be met by replacing non-eligible liabilities (e.g. senior bonds with < 1 year maturity) with MREL-eligible liabilities. To address part of the MREL funding needs, banks could also make other balance sheet adjustments rather than just resort to new issuances of MREL liabilities. Finally, it is assumed that all banks can issue new MREL instruments; it is only the price at which they can do so that matters.

[59] As described, in both cases, it is assumed that G-SIBs and O-SIIs are subject to a partial subordination requirement, while other banks are subject to a partial recapitalisation requirement.

[60] The calculations are done using aggregate banking sector figures for interest income, interest expenses, total equity, loan volume and total assets. The data source is the ECB's consolidated banking statistics. ROE calculations are done entirely on net interest income components, while leaving other income components and equity constant.

of banks becoming less risky. Thus, the derived effect on loan rates represents something closer to an upper bound estimate. In reality, banks would have various options to adjust to changes in required capital and liquidity requirements other than increasing loan rates, including by reducing ROE, reducing operating expenses[61] and increasing sources of non-interest income. Those alternative options would not necessarily be neutral in terms of GDP impact.

Finally, the reduction in long-term GDP relative to the status quo benchmark is estimated using several dynamic stochastic general equilibrium macroeconomic models with financial frictions.[62] The macroeconomic impact is computed in each model by changing key parameter values to obtain steady states characterised by higher lending spreads. The long-run effects on output are then computed as percentage changes relative to the baseline steady state.

3.3.2 Findings

a) Macroeconomic benefits

Qualitative analysis

The implementation of MREL may help mitigate risk-taking behaviour and mispricing previously linked to expectations of public support. This would lower the probability of failure among institutions and the impact that such failures generate in cases of systemic financial crises.

In addition, MREL may reduce the cost associated with large bank failures and financial crises, as it enables authorities to recapitalise failing banks in resolution without resorting to public money. By not having to lend in order to finance the bail-out of banks, governments will have more ability to use fiscal policy to aid the economy in a crisis.

Finally, severing the link between banks and their sovereign should be beneficial for sovereign debt yields in general.

[61] Banks tend to improve efficiency and cost-to-income ratios continuously, and not only due to the introduction of MREL.

[62] Many of the models were used in previous BCBS/FSB macroeconomic impact studies of regulatory reforms (e.g. Basel III, G-SIBs, derivatives reforms and TLAC). The suite of macroeconomic models employed here include Angeloni and Faia (2013), Boissay, Collard and Smets (2015), Christiano, Motto and Rostagno (2010), Clerc et al. (2015), Darracq, Kok and Rodriguez (2011), Darracq, Hałaj and Kok (2016), Darracq, Jacquinot and Papadopoulou (2016), De Fiore and Tristani (2015), Gertler and Karadi (2011) and Jaccard and Smets (2015).

MREL impact on market discipline, banks' riskiness and financial stability

Through the financial crisis, large financial institutions and market participants came to expect the provision of bail-out funds should hardship emerge. The existence of expectations of public bail-out induces moral hazard and reduces market discipline by diminishing the incentive for bondholders to control and monitor bank risks. In contrast, it is the implementation of MREL—combined with other financial sector safety- and stability-enhancing regulations—that may mitigate risk-taking and help to improve the market pricing of risk.

International literature and academic analysis[63]—which has been used by both the BIS and the Bank of England[64] when assessing the benefits stemming from TLAC and MREL—suggest that systemic banks would be around 33% less likely to fail. A BIS (2015) report[65] on the impact of TLAC, referring to the work done by Afonso et al. (2014) and Brandao-Marques et al. (2013), suggests that systemic banks would reduce their probability of default by around 30% when government support assumptions (as measured via ratings) are removed. For an average jurisdiction, this is predicted to reduce the probability of a crisis by slightly less than 30% (e.g. a reduction from a 1% probability to a 0.7% probability of crisis). The BIS (2015) report estimates that the likelihood of a crisis would be reduced by 35% in 'central estimates' when G-SIBs have a high market share, which would be the case when basically all banks have an MREL requirement. The Bank of England[66] (2015) reached a similar finding in its impact assessment of MREL, estimating the reduction of the probability of a crisis as being between 26% and 41% in the United Kingdom. Based on these studies, it is assumed (in this report) that **the probability of a crisis is reduced by 33% due to MREL as a baseline scenario, but 26% and 40% reduction have also been tested to cover the full range in the literature and thereby to provide a sensitivity analysis**.

Taking into account new capital and liquidity requirements, **the probability of a crisis is set at 2.3% without any TLAC regime in the BIS (2015) report**. It is clearly outlined in that report that, as the baseline, banks have to satisfy a minimum total capital requirement of 8% of RWAs, a capital conservation buffer of 2.5% of RWAs and an average G-SIB buffer of 1.3%. In this respect, using an average of the conversion factors between total capital ratios and tangible common equity (TCE) ratios for different types of banks that are included in the BCBS Long-term Economic Impact (2010) study[67] (also assuming that the net stable funding ratio (NSFR) = 1), this would correspond to a probability of a crisis of 2.3%. It is worth mentioning, however, that this can be seen as a conservative estimate, as it is implicitly assumed that G-SIB buffers apply to all banks and not just G-SIBs. The simulation result of probabilities in Brooke et al. (2015) used by the Bank of England

[63] See summary in, for example, Brooke et al. (2015), Measuring the macroeconomic costs and benefits of higher United Kingdom bank capital requirements, Financial Stability Paper No. 35, Bank of England, available here: http://www.bankofengland.co.uk/financialstability/Documents/fpc/fspapers/fs_paper35.pdf.

[64] Bank of England (2015), The Bank of England's approach to setting MREL, Consultation on a proposed Statement of Policy, available here: http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelconsultation2015.pdf.

[65] Bank of International Settlements (2015), 'Assessing the economic costs and benefits of TLAC implementation', Report submitted to the FSB by an experts group chaired by Kostas Tsatsaronis, November 2015, available here: http://www.bis.org/publ/othp24.pdf.

[66] Bank of England (2015), The Bank of England's approach to setting MREL, Consultation on a proposed Statement of Policy, December 2015, available here: http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelconsultation2015.pdf.

(2015) in its assessment, however, shows that there is less than a 1% probability of a crisis in an average risk environment in the United Kingdom.

Based on these results, **both probabilities of a crisis (1% and 2.3%) without MREL will be used in the analysis below**.

MREL impact on the costs of a crisis

Reductions in costs stemming from replacing bail-outs with orderly resolution come from increased certainty on what happens when banks fail, by avoiding inflating public debt and putting a constraint on fiscal policy. The BIS (2015) report finds that, based on past recapitalisation needs, TLAC can reduce the cost of a crisis compared with bail-outs by about 3.8% of annual GDP. It is also suggested that the overall discounted effect of changes in sovereign yields on GDP in the occurrence of a crisis is about 1.6% of annual GDP. Therefore, the total impact on the cost of crises can be calculated by adding these two effects. This 5.4% of annual GDP actually reflects an average impact across G-SIB home jurisdictions. It is highlighted, however, that the exact impact for a given country will depend on the size of G-SIBs headquartered in that country relative to the overall economy. In its impact study, the Bank of England (2015) predicts that these two effects together may reduce the cost of a financial crisis by between 5.4% and 11.4% of GDP. **The analysis below will make use of both estimates, given that 11.4% is specific to the United Kingdom while 5.4% is only for TLAC and does not take into account that all banks will have MREL.**

Quantification of MREL benefits

Taking into account all the aforementioned arguments, the quantification of benefits is conducted under the following assumptions:

- **The probability of a crisis without MREL** is assumed to be either **1% or 2.3%**. The first calibration (1%) corresponds to the Bank of England (2015) assessment for the United Kingdom, while the second calibration (2.3%) corresponds to the assumption used in the BIS (2015) report on the TLAC impact assessment. As stated above, it is assumed that MREL would reduce these **probabilities by 26%, 33%, or 40%** with **33% as a baseline scenario**;
- **Cost reduction** (i.e. cost savings from replacing bail-outs with orderly resolution) is assumed to range between **5.4% and 11%**;
- **Initial GDP drop** is assumed to range between 8% and 11%. 10% is assumed to be the scenario for Member States that had to seek financial support, on the basis of the BIS Long-term Economic Impact (2015) study. The median drop in output across crises and across studies is around 9%-10%. As a result, for other Member States, **an 8% initial GDP drop is assumed**;
- The share of the **permanent loss of GDP** is assumed to be either **25% or 50% of initial GDP drop** due to the crisis. This is a conservative assumption. Brooke et al. (2015)[68] have collected estimates from several studies that, in many cases, have a higher share of permanent loss. However, many of them also indicate a lower initial drop in GDP. Brooke et al. (2015) estimate

[68] See Table 4 on page 11 in Brooke at al. (2015) for a summary of the results.

that the permanent loss is 4% of GDP in the United Kingdom, while Romer and Romer (2015)[69] estimate a permanent loss of 3% of GDP for advanced economies. Our assumption, coupled with the assumed initial loss of 10% of GDP, would correspond to a permanent loss of 2.5% or 5% of GDP respectively;

- **The crisis time horizon** is assumed to be either a **3- or 5-year** period, which is the period of temporary output loss;
- **The discount rate** is assumed to be either **2.5% or 5%**. These two calibrations have been used in other studies (see, for example, the BIS Long-term Economic Impact (2015) study). The latter calibration (5%) may be considered as conservative, in the current low interest rate environment, as a higher discount rate would imply a lower cumulative cost and thus there is less benefit from lowering it.

Table 18: MREL benefits based on various calibrations and assumptions

			3-year temporary loss 1% probability of crisis without MREL				3-year temporary loss 2.3% probability of crisis without MREL				5-year temporary loss 1% probability of crisis without MREL				5-year temporary loss 2.3% probability of crisis without MREL			
			25% perm. loss		50% perm. loss		25% perm. loss		50% perm. loss		25% perm. loss		50% perm. loss		25% perm. loss		50% perm. loss	
	Risk reduction	GDP drop	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%
Cost reduced 5.4% points	26%	8%	0.299	0.194	0.497	0.288	0.688	0.445	1.143	0.662	0.327	0.220	0.516	0.305	0.753	0.505	1.186	0.702
		9%	0.331	0.213	0.554	0.319	0.762	0.490	1.274	0.734	0.363	0.242	0.575	0.339	0.836	0.557	1.323	0.779
		10%	0.363	0.232	0.611	0.350	0.836	0.534	1.405	0.805	0.399	0.265	0.635	0.372	0.918	0.609	1.460	0.855
		11%	0.396	0.251	0.668	0.381	0.911	0.578	1.537	0.876	0.435	0.287	0.694	0.405	1.001	0.661	1.597	0.932
	33%	8%	0.365	0.231	0.616	0.351	0.839	0.532	1.417	0.807	0.401	0.264	0.640	0.373	0.922	0.608	1.472	0.858
		9%	0.406	0.256	0.689	0.390	0.933	0.588	1.584	0.898	0.447	0.293	0.716	0.415	1.027	0.674	1.646	0.955
		10%	0.447	0.280	0.761	0.430	1.027	0.644	1.750	0.989	0.492	0.321	0.791	0.457	1.132	0.739	1.820	1.052
		11%	0.488	0.304	0.833	0.469	1.122	0.700	1.917	1.079	0.538	0.350	0.867	0.500	1.237	0.805	1.994	1.149
	40%	8%	0.431	0.269	0.735	0.414	0.991	0.618	1.691	0.952	0.474	0.309	0.764	0.441	1.091	0.710	1.758	1.014
		9%	0.480	0.298	0.823	0.462	1.105	0.686	1.893	1.062	0.530	0.344	0.856	0.492	1.219	0.790	1.969	1.132
		10%	0.530	0.328	0.911	0.510	1.219	0.754	2.095	1.172	0.585	0.378	0.948	0.543	1.346	0.869	2.179	1.248
		11%	0.580	0.358	0.999	0.557	1.334	0.822	2.297	1.282	0.640	0.413	1.039	0.594	1.473	0.949	2.390	1.366

			3-year temporary loss 1% probability of crisis without MREL				3-year temporary loss 2.3% probability of crisis without MREL				5-year temporary loss 1% probability of crisis without MREL				5-year temporary loss 2.3% probability of crisis without MREL			
			25% perm. loss		50% perm. loss		25% perm. loss		50% perm. loss		25% perm. loss		50% perm. loss		25% perm. loss		50% perm. loss	
	Risk reduction	GDP drop	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%	δ = 2.5%	δ = 5%
Cost reduced 11% points	26%	8%	0.340	0.235	0.538	0.329	0.783	0.541	1.238	0.758	0.369	0.261	0.557	0.347	0.848	0.600	1.282	0.798
		9%	0.373	0.254	0.595	0.360	0.857	0.585	1.369	0.829	0.405	0.284	0.617	0.380	0.931	0.652	1.419	0.874
		10%	0.405	0.274	0.652	0.392	0.931	0.629	1.500	0.901	0.441	0.306	0.676	0.413	1.014	0.704	1.555	0.950
		11%	0.437	0.293	0.710	0.423	1.006	0.673	1.632	0.972	0.477	0.329	0.736	0.446	1.096	0.756	1.692	1.027
	33%	8%	0.402	0.269	0.654	0.389	0.925	0.618	1.503	0.894	0.438	0.302	0.678	0.411	1.008	0.694	1.558	0.944
		9%	0.443	0.293	0.726	0.428	1.020	0.674	1.670	0.984	0.484	0.330	0.753	0.453	1.114	0.760	1.732	1.042
		10%	0.484	0.318	0.798	0.467	1.114	0.730	1.836	1.075	0.530	0.359	0.829	0.495	1.218	0.825	1.906	1.138
		11%	0.525	0.342	0.871	0.507	1.209	0.787	2.003	1.165	0.575	0.388	0.904	0.537	1.323	0.891	2.080	1.235
	40%	8%	0.464	0.302	0.769	0.448	1.068	0.696	1.768	1.029	0.508	0.342	0.798	0.474	1.168	0.788	1.835	1.091
		9%	0.514	0.332	0.857	0.495	1.182	0.764	1.971	1.139	0.564	0.377	0.890	0.526	1.296	0.868	2.046	1.209
		10%	0.564	0.362	0.944	0.543	1.296	0.832	2.172	1.249	0.619	0.412	0.981	0.576	1.423	0.947	2.257	1.326
		11%	0.614	0.391	1.032	0.591	1.411	0.900	2.375	1.359	0.674	0.446	1.073	0.628	1.550	1.027	2.467	1.443

Notes: β is the part of the loss that is supposed to last for 5 years, while the rest (1-β) of the loss will be permanent. For β = 0.75, then 25% of the output loss experienced will be permanent. δ is the discount rate. Permanent loss = 'output drop' $\times (1-\beta) \times \left[\frac{1}{1-\frac{1}{1+\delta}}\right]$.

Overall, the positive impact on GDP ranges from 19.4 bps to 246.7 bps. However, this wide range of the possible benefits is driven by different underlying assumptions in many dimensions.

It is important to highlight that the approach followed provides aggregate results and, to this end, the benefits may vary across Member States. Clearly, different states and levels of the input variables may vary significantly between countries, depending on the idiosyncratic characteristics of each country. In particular, significant differences can be identified in both macroeconomic and financial market dimensions and sensitivity to negative systemic shocks. All of these may affect

[69] Romer, C and Romer, H (2015), 'New evidence on the impact of financial crises in advanced countries', National Bureau of Economic Research (NBER) Working Paper 21021, March, available at: www.nber.org/papers/w21021.

the probability of a crisis, the magnitude of the permanent GDP loss, the length of the crisis, the applied discount rate and other assumptions made.

In a baseline scenario,[70] **the benefits of introducing MREL range between 23 and 92 bps of annual GDP** depending on the length of the crisis, the discount rate and the initial probability of a crisis. **The median benefit value is 47 bps of annual GDP.** Under different sets of assumptions (e.g. for Member States that had to seek financial assistance) and a 2.3% probability of a crisis without MREL, a discount rate of 2.5% and the high level of permanent loss (50%) in the case of a crisis, the corresponding MREL benefits could be up to 184-191 bps.

The baseline results obtained are consistent with the other TLAC/MREL studies mentioned in the report. In comparison, the BIS (2015) report concludes (as a central estimate) that the benefit from TLAC is 48 bps for an average G-SIB home jurisdiction. The Bank of England[71] (2015) estimates that the benefits associated with MREL are likely to be within a range of 30-90 bps of annual GDP.

b) Macroeconomic costs of MREL

Impact on banks' cost of funding

Assessing the precise impact of the MREL and subordination requirement on debt pricing requires an analysis of several factors that are difficult to model ex ante (prior to the setting of the MREL requirements). The present analysis focuses on historical senior unsecured bond pricing under (i) structural subordination, (ii) pricing based on average long-term credit ratings, and (iii) pricing under statutory subordination.

It is important to note that the estimates assume no Modigliani-Miller effect even in the long run, which may not be the case to a certain degree. Thus, the economic costs of higher requirements may be overestimated.

(i) Impact of structural subordination

The spread developments between structurally subordinated senior unsecured debt issued by HoldCos and OpCos indicate a subordinated debt premium.

Figure 18 shows the spread developments of senior unsecured debt issued by a selection of HoldCos and OpCos of the same groups[72] headquartered in the United Kingdom. The data shows that, after publication of the consultative version of TLAC proposals in November 2014, the differential between the mid Z-spread[73] of the senior unsecured bonds issued by HoldCos and the

[70] In this scenario, MREL is assumed to reduce the probability of a crisis by 33% and the costs by 5.4%. The GDP drop is assumed to be 8%, of which 25% (i.e. 2 percentage points) is assumed to be permanent. The length of the crisis (3 or 5 years), the discount rate (2.5% or 5%) and the initial probability of a crisis without MREL (1% or 2.3%) are allowed to vary.

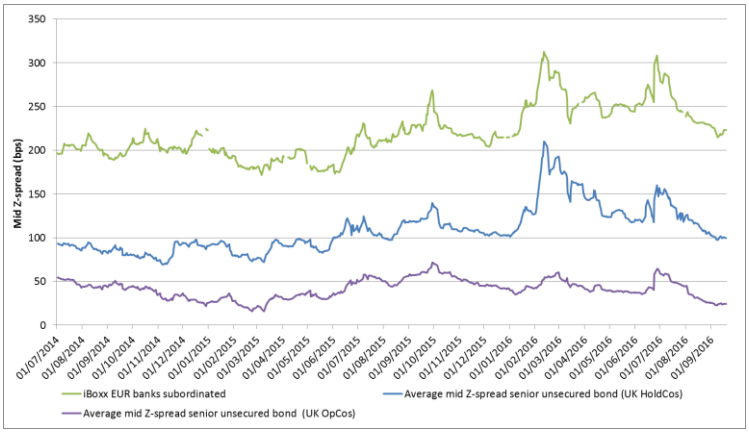
[71] http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelconsultation2015.pdf.

[72] Given the limited data availability for Swiss and Belgian banking groups with a HoldCo structure, the following senior unsecured debt is included in the sample: Barclays (HoldCo BACR 1 1/2 04/01/22, OpCo BACR 2 1/8 02/24/21), RBS (HoldCo RBS 1 5/8 06/25/19, OpCo RBS 5 3/8 09/30/19), HSBC (HoldCo HSBC 6 06/10/19, OpCo HSBC 4 01/15/21), and Lloyds (HoldCo LLOYDS 3.1 07/06/21, OpCo LLOYDS 5 3/8 09/03/19).

[73] For this analysis, the mid Z-spread is used. This is a Bloomberg calculated spread that would have to be added to the spot yield curve so that the bond's discounted cash flows equal the bond's mid price. Each cash flow is discounted using its maturity and the spot rate for that maturity term, so each cash flow has its own zero-coupon rate.

senior unsecured bonds issued by OpCos widened to around 65 bps at the end of December 2014 from around 39 bps at the end of October 2014 (+ 26 bps). In particular, the mid Z-spread of the senior unsecured bonds increased by 17 bps in the same period.

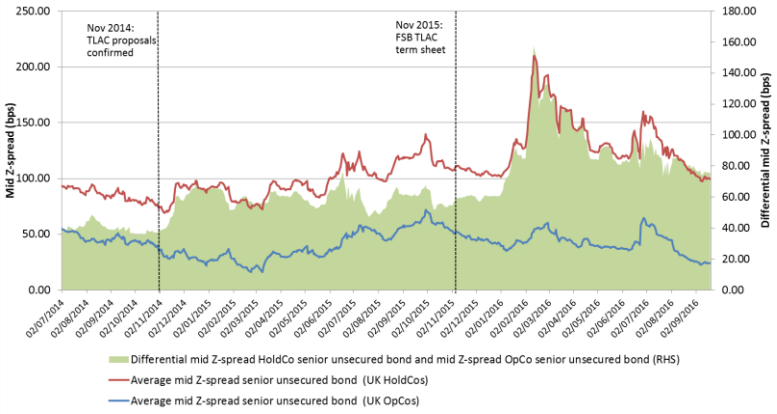
Figure 18: Mid Z-spreads in bps for senior unsecured bonds issued by United Kingdom HoldCos and United Kingdom OpCos and mid Z-spreads for EUR-denominated subordinated bank bonds



Source: Bloomberg, Markit, EBA calculations

This development is consistent with market investors having integrated the higher probability of senior unsecured bonds being bailed-in by imposing a higher risk premium for these types of instruments.

Figure 19: Average mid Z-spreads in bps for senior unsecured bonds issued by United Kingdom HoldCos and United Kingdom OpCos



Source: Bloomberg, EBA calculations

Regarding the sharp increases in the chart, it is worth noting that the peaks at the beginning of 2016 are likely to be driven by the effect of other unrelated factors on financial markets—e.g. the drop of crude oil prices to the lowest levels in 13 years or China's economic slowdown

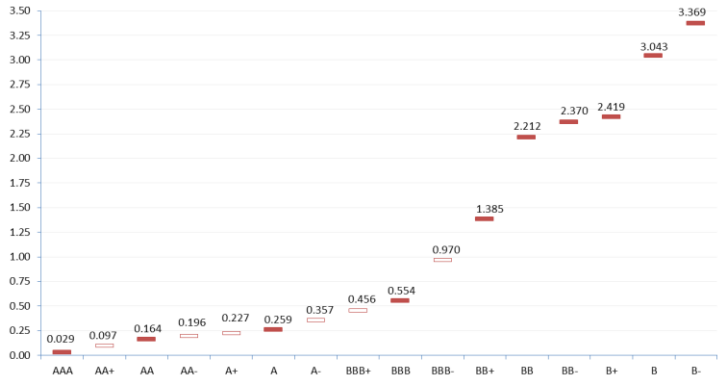
(January/February 2016).[74] The increase in the spreads at the end of June 2016 may be related to the results of the Brexit referendum.

(ii) Pricing based on average long-term credit ratings

For G-SIBs and O-SIIs in the sample, the cost of issuing senior debt was approximated by using an appropriate yield-to-maturity (YTM) curve based on weighted average long-term credit ratings. Separate averages were calculated for G-SIBs and other banks in a Member State.

Figure 20: EUR Europe financials yields mid YTM (BVAL[75])

(Maturity – 5 years; ratings – AAA to B-; dark red values – actual market data; light red values – linearly interpolated results)



Source: Bloomberg, EBA calculations

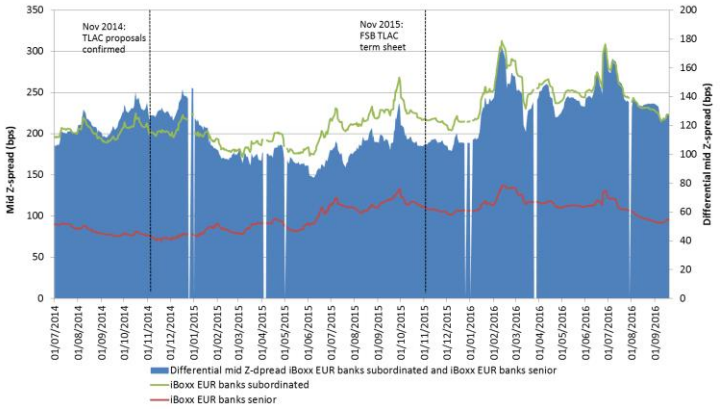
Bloomberg information on the yield curves of EUR-denominated senior unsecured fixed rate bonds issued by European banks (with composite ratings of AAA; AA+, AA or AA-; A+, A or A-; BBB+, BBB or BBB-; BB+; BB; BB-; and B+, B or B-) was used as a proxy for senior unsecured debt instrument pricing. A 7-year maturity was assumed as a benchmark for quantitative impact assessment purposes. The cost of issuing subordinated debt was derived by adding a spread over the respective senior debt yield of i) 65 bps, implied by statutory subordination debt pricing for G-SIBs, and ii) 133 bps, implied by the difference between the 5-year Europe Senior Financial index and the 5-year Europe Subordinated Financial index[76] (as of 17 October 2016) for non-G-SIBs. For other banks in the sample, a conservative assumption was made that, due to their limited or lack of previous experience in accessing capital markets and potential lack of long-term credit ratings, costs of MREL instruments needed to cover MREL financing needs would be equal to the cost of equity.

[74] The differential of the mid Z-spread (bps) of United Kingdom HoldCos and United Kingdom OpCos reached 156 bps on 12 February 2016.

[75] Bloomberg's evaluated pricing service (BVAL).

[76] The subordinated debt spread is approximated using a spread between the 5-year Markit iTraxx Europe Senior Financial index and the 5-year Markit iTraxx Europe Subordinated Financial index. Both indices comprise 30 equally weighted credit default swaps on investment-grade European entities. The composition of each Markit iTraxx index is determined by the index rules. Markit iTraxx indices roll every 6 months in March and September.

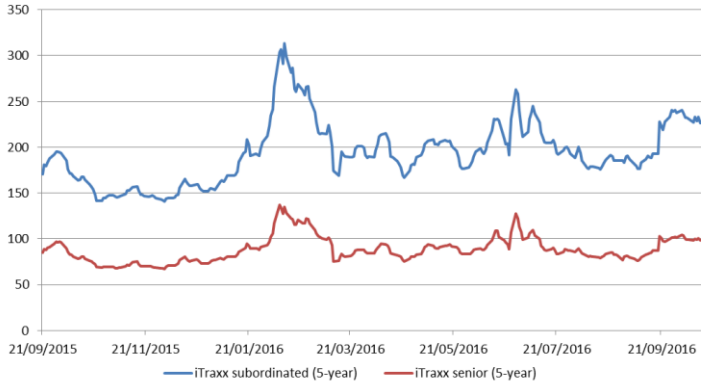
Figure 21: Mid Z-spreads of EUR-denominated senior and subordinated bank bonds



Source: Markit, Bloomberg, EBA calculations

The cost assumption of additional funding costs to cover any MREL funding needs covers the medium-term outlook—i.e. it assumes an average cost of MREL issuances over the period of 2017-2022. It is important to note that longer transitional periods may expose banks to higher interest rates and a steeper yield curve environment.

Figure 22: 5-year iTraxx subordinated and iTraxx senior indices



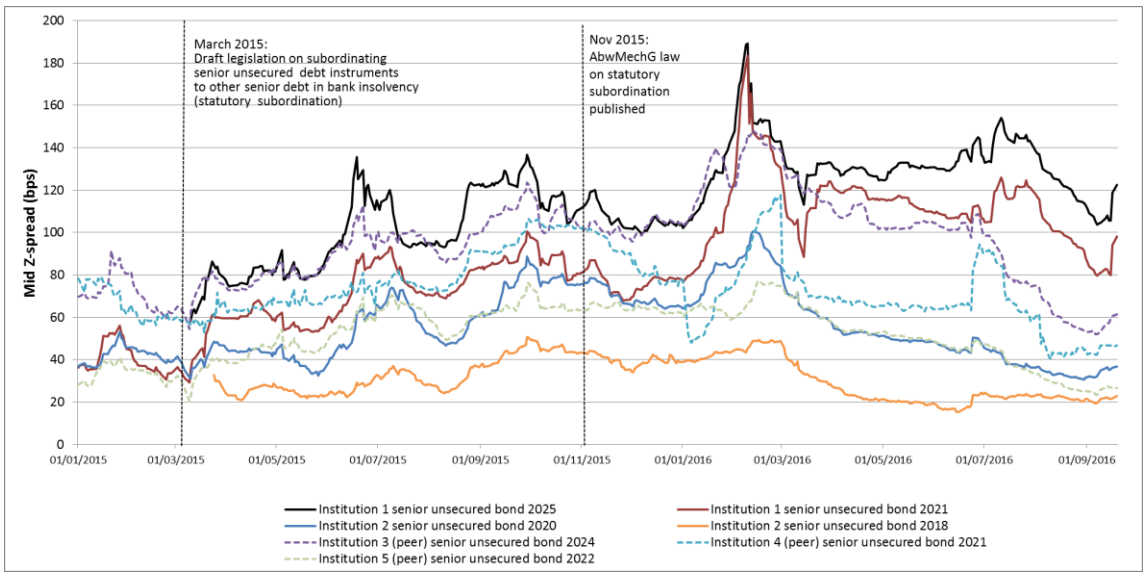
Source: Markit, Bloomberg, EBA calculations

It is also important to keep in mind that credit rating agencies have issued reports stating that they are likely to lower credit ratings on certain financial institutions due to the implementation of MREL. This is due to the fact that these ratings agencies foresee it being less likely that financial institutions will receive public government support to maintain solvency and honour all debts. Nevertheless, some ratings agencies have not lowered their ratings expectations for larger, already highly rated institutions, as the expected negative impact of regulation on creditworthiness is low. Moreover, a number of rating agencies have stressed that significant amounts of subordinated MREL may increase the ratings for senior debt (as it would become less likely to experience losses).

(iii) Impact of statutory subordination

Resolution planning is at an early stage for most European institutions and, despite prospective laws on statutory debt subordination, its impact on pricing is currently ambiguous. The analysis of the evolution of the spreads of senior unsecured bonds after the announcement of the draft legislation on subordinating senior unsecured debt instruments to other senior debt for bank insolvency (statutory subordination) in Germany is ambiguous.

Figure 23: Mid Z-spread in bps for senior unsecured bonds issued by Institution 1 and Institution 2 and peer institutions

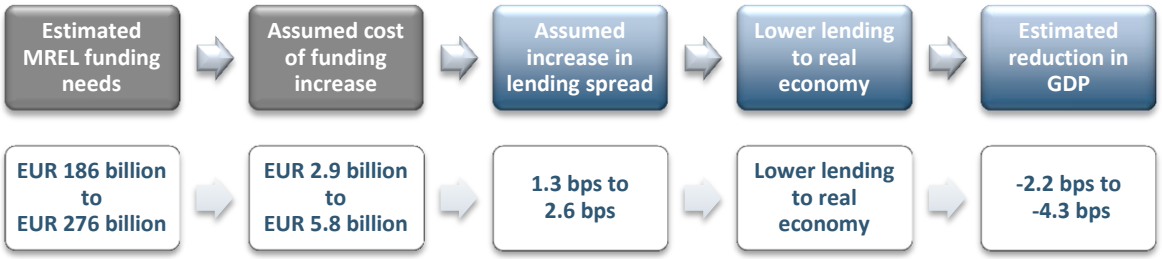


Source: Bloomberg, EBA calculations

Long-term senior unsecured bonds that would be subject to the legislation on subordination incurred a negligible risk premium compared to long-term senior unsecured bonds that would not be subject to this legislation. However, a final conclusion will be more visible as the resolution framework and planning are communicated and understood by the investor community. The figure above illustrates the spread development after the announcement of the draft legislation in Germany for selected institutions that would be directly affected by the draft law (Institution 1 and Institution 2) and peer institutions of other countries (Institutions 3, 4 and 5). The increase of the senior bond spreads of Institution 1 and Institution 2 after the emergence of the draft proposal occurs simultaneously with the other peer institutions. As recent differences in pricing may be due to other bank-specific factors unrelated to the subordination law, no specific impact conclusion from the law on statutory subordination can be drawn.

Impact on GDP

Figure 24: Macroeconomic impact assessment (the EU aggregate based on the sample of banks)



At an aggregated level across the EU, the incremental **increase in funding costs ranging between EUR 2.9 billion (LA buffer) and EUR 5.8 billion (buffer/8%)** can be translated into a **corresponding lending spread increase** of between **1.3 and 2.6 basis points**. According to the median estimate across the suite of macroeconomic models, this could translate into an **annual GDP reduction** ranging from -**0.6 to -6 bps** depending on model. **The median estimate** (across macroeconomic models) shows **costs from -2.2 to -4.3 bps**.

It should be noted that the results obtained are based on certain assumptions (e.g. amount of MREL funding needs, scale and scope of subordination requirement) and are subject to the methodology and limitations explained above.

Table 19: Macroeconomic cost estimates

	Scenario A		Scenario B	
	LA buffer	Buffer/8%	LA buffer	Buffer/8%
Funding cost increase (EUR billion)	2.91	5.01	3.15	5.82
Lending spread increase (bps)	1.30	2.23	1.40	2.59
Macroeconomic cost estimates *(long-run impact on annual GDP in bps)*				
Median (across macroeconomic models)	-2.2	-3.7	-2.3	-4.3
Lower estimate	-0.6	-1.1	-0.7	-1.3
Upper estimate	-3.0	-5.2	-3.3	-6.0

As banks' MREL funding needs—and hence also the associated costs—differ widely across countries, macroeconomic cost estimates for the most and least affected Member States are presented in Table 20. The highest observed costs in a Member State (based on the results of the median model used) are 71-127 bps, depending on calibration and assumed funding costs.[77] The estimated impact in a Member State with the second highest costs ranges between 19 and 46 bps, depending on calibration and assumed funding costs.

[77] These sizeable effects are a result of the mechanical translation of higher funding costs into lending spreads, assuming constant ROE targets. It cannot be excluded that banks facing such sizeable funding cost increases would have stronger incentives (than banks with lower funding cost increases) to try to mitigate the impact on their lending relationships by, for instance, increasing lending rates less than the funding costs.

Table 20: Macroeconomic cost estimates (the most and the least affected Member States)

	Scenario A		Scenario B	
	LA buffer	Buffer/8%	LA buffer	Buffer/8%
Maximum impact by country				
Lending spread increase	44.5	68.4	50.5	79.4
Macroeconomic cost estimates *(long-run impact on annual GDP in bps)*				
Median (across macroeconomic models)	-71.2	-109.4	-80.7	-127.0
Lower estimate	-43.0	-66.1	-48.8	-76.7
Upper estimate	-103.3	-158.8	-117.2	-184.4
Minimum impact by country				
Lending spread increase	0.0	0.2	0.0	0.2
Macroeconomic cost estimates *(long-run impact on annual GDP in bps)*				
Median (across macroeconomic models)	0.0	-0.4	0.0	-0.4
Lower estimate	0.0	-0.1	0.0	-0.1
Upper estimate	0.0	-0.6	0.0	-0.6

This rather high impact[78] is derived under assumptions that: i) ROE targets remain constant and ii) very high funding costs are assumed to persist, rather than be transitory. Both of these are very conservative assumptions. In reality, banks could lower their ROE target, and funding costs are expected to decrease over time as the EU capital markets develop, the macroeconomic situation in a country improves and banks build loss-absorbing capacity buffers.

As explained above, it has been acknowledged that Member States' economies may be more or less sensitive to positive and negative shocks depending on macroeconomic circumstances.

MREL impact on small and medium-sized deposit-funded institutions

The diversity of banking business models across the EU is beneficial to competition and enhances the overall banking system's efficiency. In addition, the diversity of business models is normally deemed an element that increases the resilience of the banking system to external shocks, thus protecting financial stability. Retail banks are often important providers of banking services for SMEs and individuals across Europe.

The results demonstrated in the impact assessment section are based on a sample that does not cover all banks in Europe and, therefore, might underrepresent the impact on small deposit-funded institutions—especially given their lack of experience in terms of debt market access. In addition, **MREL requirements may be difficult to reach for many entities due to the domestic markets' limited capacity to absorb the planned issuances. Even if banks were able to access the markets, a spread could be significantly higher than that required for a larger institution.** This, in turn, would negatively impact on their ability to provide funding to the real economy at

[78] It should be kept in mind that the macroeconomic models have been estimated (or, in some cases, calibrated) for the euro area as a whole and therefore may not lend themselves well to country-specific simulations. Moreover, while the employed macroeconomic models are (in principle) linear and hence scalable to the lending spread shock, it cannot be excluded that the macroeconomic propagation may be different for a lending rate increase of, for instance, 5 bps than it would be for an 80-bps increase.

reasonable prices without increasing the risk profile of their portfolios.

Small and medium-sized deposit-funded institutions are usually financed by deposits and covered bonds, and seldom issue debt instruments in the markets. For those entities, no reference exists to assess the expectation of investors' pricing of MREL-eligible instruments. It does not seem unreasonable to predict that the requested spreads would be well above those applied to G-SIIs and O-SIIs and could be close to the cost of new equity issuance. This is partly addressed in the impact assessment by assuming that the costs of senior MREL instruments for non-G-SIBs and non-O-SIIs will be equal to the cost of equity (8%). The precise impact of higher spreads over such entities' performances is impossible to assess, but it is likely to be material. However, it cannot be excluded that the short-term cost of debt increase will be counterbalanced by an overall reduction in bank risk in the long term.

c) Conclusions – The overall impact on the economy

The expected net benefit from the introduction of an effective resolution regime, and particularly from an MREL requirement, depends on the scenarios being considered. With the methodology used and under the assumptions made, the macroeconomic benefits from the introduction of MREL outweigh the associated macroeconomic costs.

Overall net MREL benefits are positive and range between 17 and 91 bps. Even in the case of Member States assessed as most affected, under the assumptions of a 2.3% probability of crisis without MREL, a discount rate of 2.5%, and the high level of permanent loss (50%) in the case of crisis, MREL benefits surpass the highest estimated costs of -127 bps and net MREL benefits are expected to remain positive (especially in the steady state).

3.3.3 Current volumes of MREL issuances, maturity profile and possible implications in terms of future market capacity

Public market data on European banks' debt maturity profiles[79] reveals that the banks included in a subsample[80] have more than EUR 2 202 billion[81] of senior unsecured and subordinated debt maturing in 2018 or later. Of that amount, in 2018 and onwards, there will be a rollover of EUR 1 451 billion of senior unsecured debt. This amount compares to the EUR 1 193 billion of

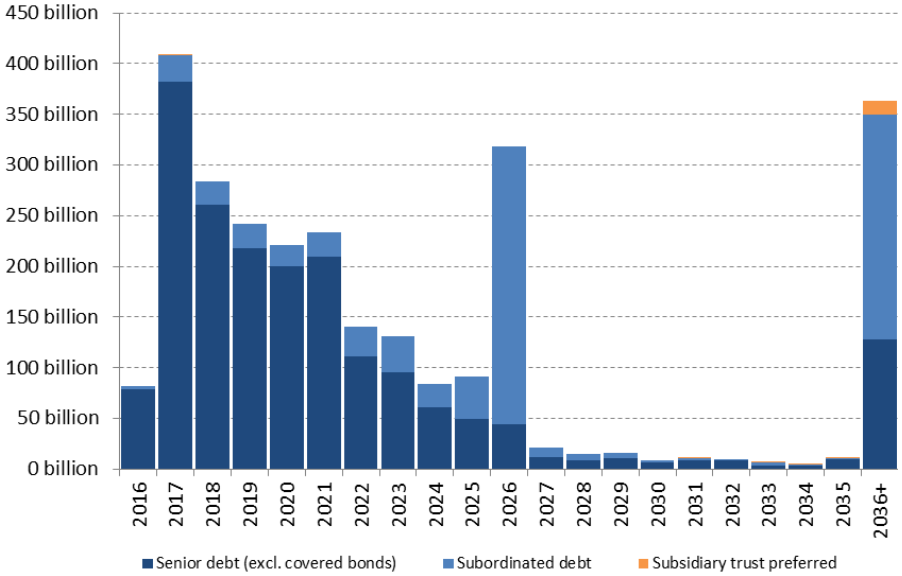
[79] Aggregate data for all European banks (listed & non-listed) with full SNL Financial coverage: Erste Group Bank AG, Raiffeisen Bank International AG, Dexia SA, KBC Group NV, Bank of Cyprus Plc, Deutsche Bank AG, Commerzbank AG, Deutsche Zentral-Genossenschaftsbank AG, Bayerische Landesbank, Landesbank Berlin Holding AG, Westdeutsche Genossenschafts-Zentralbank AG, Danske Bank A/S, National Bank of Greece SA, Eurobank Ergasias SA, Alpha Bank AE, Piraeus Bank SA, Banco Santander SA, Banco Bilbao Vizcaya Argentaria, SA, BNP Paribas SA, Crédit Agricole SA, Groupe BPCE, Société Générale SA, Banque Fédérative du Crédit Mutuel SA, OTP Bank Nyrt., Allied Irish Banks Plc, Bank of Ireland, UniCredit SpA, Intesa Sanpaolo SpA, Banco Popolare Società Cooperativa, ING Groep NV, Rabobank Group, ABN AMRO Group NV, DNB ASA, Banco Comercial Português SA, Nordea Bank AB, Svenska Handelsbanken AB, Skandinaviska Enskilda Banken AB, Swedbank AB, Royal Bank of Scotland Group Plc, HSBC Holdings Plc, Barclays Plc, Lloyds Banking Group Plc.

[80] This is based on the SNL Financial data on European banks. The sample composition presented in this section is different from the one used in other sections of the report.

[81] No adjustment has been made by the EBA regarding the German law on subordination, which will come into effect as of January 2017.

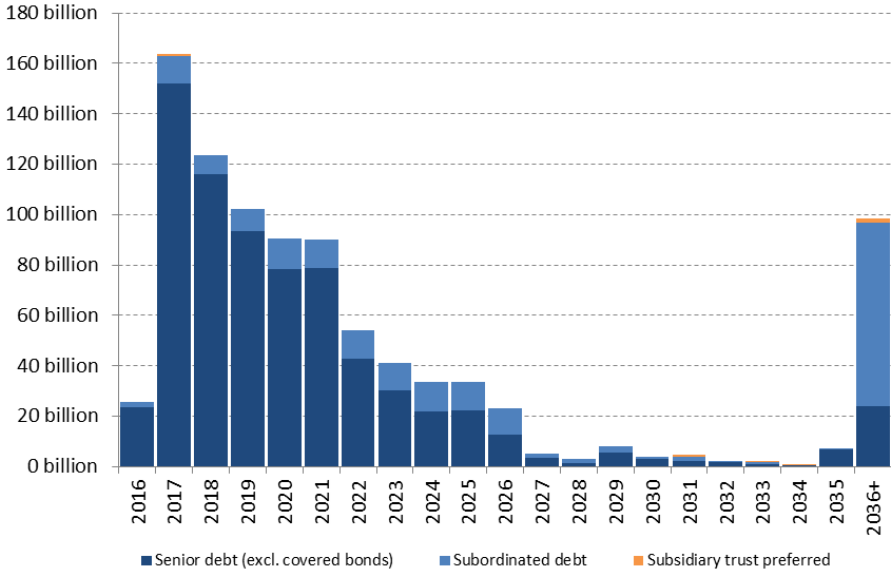
senior unsecured debt[82] held by the 133 banks in the original sample used throughout this report. Based on market data, subordinated debt maturing in 2018 and later amounts to EUR 751 billion.

Figure 25: European banks' (including G-SIBs) aggregate debt maturity profile (in EUR billion)



Source: SNL Financial

Figure 26: European banks' (excluding G-SIBs) aggregate debt maturity profile (in EUR billion)



Source: SNL Financial, EBA calculations

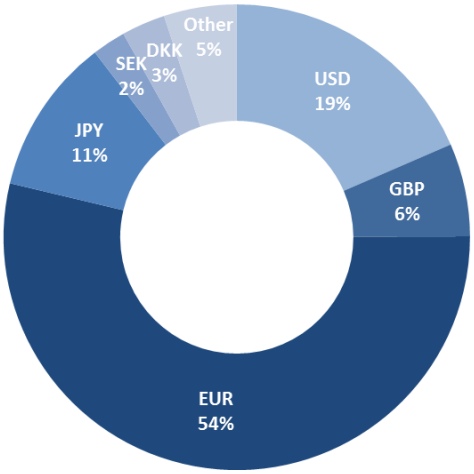
Non-G-SIBs hold more than EUR 724 billion of senior unsecured and subordinated debt maturing in 2018 or later. Of that amount, in 2018 and later, there will be a rollover of EUR 547 billion of senior unsecured debt. This amount compares to the EUR 613.5 billion of senior unsecured debt (MREL ex dep minus Own funds + subordinated debt) held by non-G-SIBs in the sample used for this report. Based on the market data sample, subordinated debt of non-G-SIBs maturing in 2018 and later amounts to EUR 177 billion.

[82] MREL ex dep minus Own fund and subordinated.

Public market information on aggregate debt[83] by currency maturing in 2018 and later (see Figure 27 and Figure 28) indicates that—besides the dominant market for issuances of instruments denominated in EUR (54%)—European banks significantly rely on funding in other currencies, predominantly in USD (19%), JPY (11%), GBP (6%) and other currencies. This indicates that banks have the potential to issue MREL-eligible instruments not only in domestic but also in international financial markets. It is important to note that G-SIBs have better access to foreign markets, as the analysis of a subsample without including G-SIBs (Figure 28) suggests a higher proportion of non-G-SIBs' funding in EUR.

Figure 27: European banks' (including G-SIBs) aggregate debt currency breakdown (debt maturing in 2018 or later)

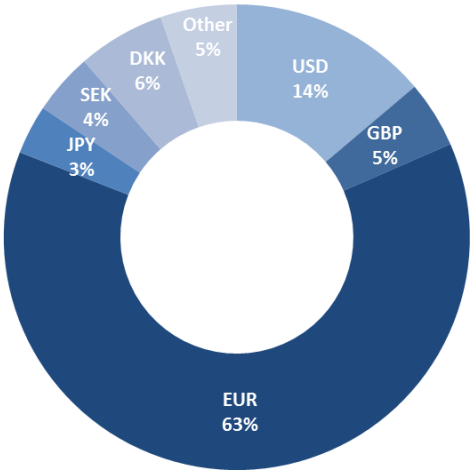
(Note: Composition is based on total outstanding debt (including covered bonds) not eligible for MREL)



Source: SNL Financial, EBA calculations

Figure 28: European banks' (excluding G-SIBs) aggregate debt currency breakdown (debt maturing in 2018 or later)

(Note: Composition is based on total outstanding debt (including covered bonds) not eligible for MREL)



Source: SNL Financial, EBA calculations

MREL funding needs in comparison with currently available MREL-eligible instruments

On an aggregated basis, an estimated EUR 58.2-208.1 billion MREL funding needs[84] would imply between a 1.5% and 5.4% increase in the current stack of MREL-eligible instruments, all other things being equal. Under the partial subordination scenario, the total MREL funding needs increase to EUR 186.1 billion to EUR 276.2 billion or 4.9% to 7.2%.

Under the partial subordination requirement, total MREL funding needs for G-SIBs and O-SIIs in subordinated debt of EUR 154.4 billion amount to 7.4% of total subordinated MREL instruments of all banks in the sample. The highest burden of the need to increase the amount of subordinated MREL instruments would fall on G-SIBs that—in order to obtain EUR 110 billion subordinated instruments—would have to increase the current stack of own funds and subordinated liabilities by 11%. O-SIIs would have to rollover senior debt into subordinated or issue new eligible instruments of EUR 44.4 billion equal to 5.2% of their own funds and subordinated debt.

[83] Composition is based on total outstanding debt (including covered bonds) not eligible for MREL.

[84] MREL eligibility criteria, the LA buffer and the buffer/8% scenarios respectively.

Table 21: Estimated financing needs (in EUR billion; % of RWAs of the respective G-SIBs/O-SIIs samples)

	LA buffer				*Buffer/8%*			
	Without subordination	*With partial subordination*			*Without subordination*	*With partial subordination*		
		Total	*Of which subordinated*	% of RWAs		*Total*	*Of which subordinated*	% of RWAs
G-SIBs	10.0	120.0	110.0	2.0%	79.7	140.3	110.0	2.0%
O-SIIs	44.6	62.5	44.4	1.1%	110.6	118.1	44.4	1.1%
*Other**	*3.6*	*3.6*			*17.8*	*17.8*		
Total	**58.2**	**186.1**	**154.4**	-	**208.1**	**276.2**	**154.4**	-

** **Other banks** (non-G-SIBs and non-O-SIIs): 50% partial recapitalisation scenario; no subordination assumption*
Source: EBA QIS data (December 2015)

Table 22: Available MREL-eligible instruments (in EUR billion)

	G-SIBs	O-SIIs	Others	**Total**
Eligible deposits	186.4	298.8	55.3	**540.5**
Senior unsecured debt	579.6	501.4	112.1	**1 193.1**
Own funds and subordinated debt	995.9	848.9	241.8	**2 086.6**
Total MREL instruments (in EUR billion)	**1 761.9**	**1 649.1**	**409.2**	**3 820.2**

3.4 Summary of findings on MREL ratios and MREL funding needs

Main findings – MREL ratios and MREL funding needs

- The **average MREL ratio** of 133 EU banks in the EBA sample representing approximately two thirds of the EU banks' assets was approximately 37.0% of RWAs as of end December 2015.
- At the same time, individual bank results are heterogeneous. They vary depending on systemic importance, size and cross-border activity, as well as funding model (deposit-taking intensity):
    - First, the MREL ratio is slightly below average for G-SIBs (32.1% of RWAs), slightly above average for O-SIIs (41.2% of RWAs) and significantly higher (48.4% of RWAs) for the remaining banks (non-G-SIBs and non-O-SIIs);
    - Second, in terms of size and cross-border activity, Group 1 banks (the largest in the sample) showed, on average, lower MREL ratios (35.1% of RWAs) than the large and medium-sized Group 2 banks. However, the smallest Group 2 banks in the sample have significantly lower average MREL ratios (34.1% of RWAs) and half of those small banks (more than 20 institutions in the sample) exhibit MREL ratios below 20% of RWAs;
    - Finally, in terms of funding profiles, mainly deposit-funded banks have lower than average MREL ratios, with half of deposit-reliant banks exhibiting MREL ratios below 10% of TLOF (22% of RWAs).
- **Estimated funding needs** to reach the two scenarios considered (the LA buffer and the buffer/8% scenario) in the steady-phase range between EUR 66.5 billion (under the LA buffer

scenario without the subordination requirement, full recapitalisation) and EUR 276.2 billion (under the buffer/8% scenario with a partial subordination requirement for G-SIBs and O-SIIs and partial recapitalisation for other banks).

- When applying the buffer/8% scenario (in which banks should meet the higher of twice capital requirements and buffers and 8% of TLOF), the analysis shows that in only 6 cases (out of 133) is the 8% of TLOF requirement higher than the general MREL requirement in the Buffer scenario, or the institutions' current MREL eligible resources. As a result, an 8% of TLOF requirement would not be constraining.
- In order to assess the minimum subordination requirements stemming from the TLAC term sheet, a partial subordination requirement of 14.5% of RWAs + CBR has been assumed for G-SIBs. In addition, with a view to an improved resolvability of O-SIIs and a level playing field with G-SIBs, a partial subordination requirement of 13.5% of RWAs + CBR has also been tested in relation to O-SIIs, assuming that it would only enter into force in 2022.

Estimated financing needs (in EUR billion; % of RWAs of the respective G-SIBs/O-SIIs samples)

	LA buffer				*Buffer/8%*			
	Without subordination	*With partial subordination*			*Without subordination*	*With partial subordination*		
		Total	*Of which subordinated*	% of RWAs		*Total*	*Of which subordinated*	% of RWAs
G-SIBs	10.0	120.0	110.0	2.0%	79.7	140.3	110.0	2.0%
O-SIIs	44.6	62.5	44.4	1.1%	110.6	118.1	44.4	1.1%
*Other**	*3.6*	*3.6*			*17.8*	*17.8*		
Total	**58.2**	**186.1**	**154.4**	**-**	**208.1**	**276.2**	**154.4**	**-**

** **Other banks** (non-G-SIBs and non-O-SIIs): 50% partial recapitalisation scenario; no subordination assumption*

Source: EBA QIS data (December 2015)

- The TLAC minimum partial subordination would require G-SIBs in the sample to issue an additional EUR 110 billion in subordinated debt in either scenario, which would account for 2.0% of their RWAs. For the O-SIIs in the sample, the tested partial subordination requirement would result in a need to increase an existing stack of subordinated debt by EUR 44.4 billion, which would account for 1.1% of their RWAs.

In relation to other banks (non-G-SIBs and non-O-SIIs), no automatic subordination requirement has been assumed. Indeed, any subordination requirement would be a case-by-case resolution authority decision and would be driven by the preferred resolution strategies, which are likely to vary (especially in relation to smaller banks, which are heterogeneous in a large number of ways). In this regard, a variant scenario assuming 50% recapitalisation rather than 100% has been tested in relation to other banks (non-G-SIBs and non-O-SIIs). Under the full recapitalisation scenario, other institutions would have MREL funding needs of EUR 12 billion in the LA buffer scenario or EUR 30 billion in the buffer/8% scenario (1.4% and 3.6% of RWAs respectively). Under the partial recapitalisation scenario, MREL funding needs would decrease to EUR 3.6 billion and EUR 17.8 billion (0.4% and 2.1% of RWAs) under the LA buffer and the buffer/8% scenarios respectively.

3.5 Summary of findings on the macroeconomic impact of MREL

Main findings – macroeconomic impact analysis

MREL benefits

In a baseline scenario,[85] **the benefits of introducing MREL range between 23 and 92 bps of annual GDP** (median estimate is 47 bps) depending on the length of the crisis, the discount rate and the initial probability of a crisis.

MREL costs

Under a partial subordination scenario for G-SIBs and O-SIIs, and partial recapitalisation assumption for Other banks (50% recapitalisation amount), **the MREL costs are in the range of -0.6 to -6 bps** (median estimate is -2.2 to -4.3 bps) based on the macroeconomic model used, the MREL calibration level and the funding costs assumptions.

Overall impact of introducing MREL

Under the assumption of full market capacity to absorb MREL funding needs, MREL calibration level and eligibility criteria (e.g. subordination), the **overall net MREL benefits are positive and range between 17 and 91 bps of annual GDP.** In the case of Member States' economies assessed as most affected, the net MREL benefits are likely to remain positive, especially in the steady state.

The actual impact of MREL introduction will depend on the capacity of markets to absorb the volumes of MREL issuances needed for the build-up of MREL, and the corresponding capacity of banks (especially deposit funded banks) to access markets, including access to deep, developed markets.

[85] In this scenario, MREL is assumed to reduce the probability of a crisis by 33% and the costs by 5.4%. The GDP drop is assumed to be 8%, of which 25% (i.e. 2%) is assumed to be permanent. The length of the crisis (3 or 5 years), the discount rate (2.5% or 5%) and the initial probability of a crisis without MREL (1% or 2.3%) are allowed to vary.

4. Reference base of MREL

Article 45(19)(i) of the BRRD requires the EBA to examine *'whether it is appropriate to base the requirement on total liabilities and own funds and in particular whether it is more appropriate to use the institution's risk-weighted assets as a denominator for the requirement'*.

This section aims to assess how well the current reference base[86] serves the purpose of the minimum requirement and identifies a number of limitations affecting its use. It further examines whether RWAs, complemented by a leverage ratio exposure backstop, could be a more appropriate reference base. Finally, it identifies a number of provisions within the BRRD and other regulations that are connected with this reference base and could be impacted by a change.

4.1 Current reference base: Total liabilities and own funds

The current reference base presents some limitations with regard to achieving the goals of MREL and offering a legally certain backdrop for the requirements.

4.1.1 Achieving the goals of MREL

MREL is meant as a mechanism to prevent bail-in avoidance by banks,[87] to ensure that an institution can be resolved, and to ensure that losses can be absorbed and—in the proportion required to achieve the resolution strategy—capital can be restored.[88] These principles are reflected in the methodology set out by the RTS on MREL and particularly the criteria for determining the amounts necessary to absorb losses and recapitalise an institution following resolution. On the one hand, the regulatory framework[89] and the SREP[90] embody a judgement regarding the amount of capital necessary to absorb losses. On the other hand, following resolution, the resolved firm will need to fulfil the conditions for authorisation by the relevant competent authority to continue any activities as a credit institution, and so will need to meet capital requirements. As a result, resolution authorities that set MREL for individual banks need to take into account these judgements. Supervisory capital ratios are therefore expected to be a major determinant of MREL levels, both for the loss absorption amount and the RCA.

[86] The terms 'reference base' and 'denominator' are used interchangeably for the purposes of this chapter.

[87] Recital 79 of the BRRD: 'To avoid institutions structuring their liabilities in a manner that impedes the effectiveness of the bail-in tool it is appropriate to establish that the institutions meet at all times a minimum requirement'.

[88] Article 45(6)(a) and (b) of the BRRD.

[89] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending previous Regulation and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2016 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending and repealing previous directives.

[90] In accordance with the EBA Guidelines on common procedures and methodologies for the SREP, available at: https://www.eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+%28Guidelines+on+SREP+methodologies+and+processes%29.pdf/.

In contrast, setting an MREL requirement based on an assessment of loss absorption and recapitalisation needs as a percentage of TLOF makes it insensitive to changes in risk in the period between MREL decisions. The level of eligible liabilities needed to absorb losses and recapitalise will depend not only on the volume of a balance sheet, but also on the average risk weight of the bank's assets, which may be affected by changing risk appetite, by balance sheet volatility or by changes in economic conditions in between two annual MREL decisions. An increase in average risk weights without a corresponding change in the MREL requirement may therefore leave institutions with inadequate loss absorption and recapitalisation capacities.

4.1.2 Defining TLOF

The BRRD defines own funds by reference to the capital framework of the CRD and the CRR. It does not, however, provide a clear definition of the total liabilities component. As a result, resolution authorities have to define and measure this component. Differing national approaches to this could stand in the way of a harmonised application of the requirement.

Accounting rules provide a relatively unambiguous framework when defining total liabilities, but also raise several practical challenges that mean this approach is not likely to result in fully consistent implementation.

First, without a uniform EU accounting framework for all the institutions subject to MREL, some institutions apply national GAAP rather than IFRS. Although the additional guidance of the legislation on the netting of derivative liabilities (discussed below) tries to overcome the difference that is probably most significant, it cannot be excluded that differing accounting treatments might significantly impact the amount of the denominator. This contrasts with the prudential treatment of derivative netting, which is harmonised.

Second, there may also be a need to further clarify how accounting liabilities interact with prudential own funds. While accounting standards identify subordinated debt as liabilities, some subordinated debt is also included (wholly or in part) in the Tier 2 own funds of an institution. The MREL calculation needs to avoid double-counting the subordinated liabilities or part thereof in the denominator.

The interaction of fair value accounting for liabilities and adjustments to own funds might also give rise to ambiguity. Fair valuation of liabilities may result in decreases in the accounting value of a liability, which are not associated with a reduction in the rights of a counterparty in insolvency. This fair value adjustment increases the calculated value of accounting equity, meaning that the total balance sheet size is unchanged. However, as prudential own funds are corrected, particularly through the deduction of the own credit risk component and through prudent value adjustments, the value of TLOF at the point of resolution might be underestimated.

The EU supervisory financial reporting framework (FINREP) is currently not a required reporting format for non-IFRS entities. Competent supervisory authorities may optionally extend FINREP to entities establishing their accounts under national GAAP. However, this would only provide a solution for the lack of a uniform accounting basis if these entities were required to additionally

report IFRS concepts through FINREP, which would impose a significant additional reporting burden.

An alternative approach would be to base the valuation of liabilities on an approach other than an accounting basis. However, any such alternative basis would face significant practical problems, particularly the need for extensive guidance on how to interpret the concept. One alternative that could be considered would be to base MREL decisions on the estimated value of liabilities in insolvency rather than on the going concern accounting framework. However, national insolvency laws differ significantly and thus create a need for distinct treatment in light of the NCWO principle.[91] An alternative valuation approach is therefore very difficult to envisage.

If the existing reference base were maintained, the definition of total liabilities should therefore be clarified through changes in the Level 1/Level 2 text.

4.1.3 Derivative liabilities and netting rights

Article 45(1) of the BRRD specifies that derivative liabilities shall be included in the denominator on the basis that full recognition is given to counterparty netting rights.

However, this provision does not specify the netting principle to be applied. In this regard, there are at least three possible options for the calculation of netting:

- Full contractual netting – Consider all netting sets on the basis of their contractual netting rights in the event of the institution's default (consistently with the RTS on the valuation of derivatives)[92] in order to define the resulting asset or liability position. This approach would maximise the theoretical consistency with the treatment of derivatives in insolvency or resolution, but it would be difficult to calculate without running an actual derivative counterparty default process;

- Accounting netting – Under IFRS, derivative contracts may be netted for accounting purposes when the reporting institution has both the right to net in the event of default *and* the intent to settle payments on a net basis during the contract's life. This has the advantage of consistency with the accounting standards and it is already calculated for accounting purposes. Nevertheless, the requirement for ongoing net settlement means the recognition of netting is more limited than the contractual netting likely to occur in the event of failure, and it may not give full recognition to netting rights;

- Prudential netting (as used for calculating RWAs or the leverage ratio exposure measure) – This allows a scope of netting that will usually be intermediate between full contractual netting and IFRS accounting netting. For prudential purposes, exposures are also calculated, including potential future exposure (PFE). This measure is already calculated for prudential purposes

[91] The principle whereby shareholders and creditors should not suffer more losses in resolution than in liquidation, cf. Article 74 of the BRRD.

[92] Commission Delegated Regulation (EU) 2016/1401 of 23 May 2016, supplementing Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms with regard to the RTS for methodologies and principles on the valuation of liabilities arising from derivatives. Available at:

http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.228.01.0007.01.ENG&toc=OJ:L:2016:228:TOC.

(although it is derivative *assets* that are calculated for prudential purposes, this value should be based on calculating the value of the same set of derivative contracts, which may take either a positive or negative value). Moving to prudential netting of derivatives would be one consequence of adopting a denominator based on RWAs/leverage exposure.

This question has been addressed by the EBA in the context of its Q&A tool.[93] According to the interpretation given, the netting principles applied for derivatives in the BRRD should be consistent with prudential rules as used for calculating RWAs and the leverage ratio exposure measure. Practitioners would benefit from the explicit recognition of this approach in the Level 1 legislation.

4.2 RWAs with a leverage ratio exposure backstop

This section describes how resolution authorities could concretely set MREL as a percentage of RWAs and the leverage ratio exposure. It further identifies the advantages of such an approach in terms of alignment with the capital framework, and discusses issues related to risk weight variability and how they can be addressed by the leverage ratio backstop.

Note that for the sample of banks included in the EBA's quantitative analysis, RWAs constitute approximately one third of the exposure amount according to the leverage ratio measure, which is broadly consistent with findings regarding average risk weights of the EU banks' portfolios from previous studies.[94]

i. Practicalities of determining MREL as a percentage of RWAs with leverage ratio backstop

In practice, the change of reference base would imply only a limited change in the methodology used by resolution authorities to set MREL.

As explained above, the current RTS on MREL—in keeping with the principles of the BRRD[95]—sets out a methodology for the calibration of MREL based on the determination of two main components:[96]

- A loss absorption amount largely driven by capital requirements (both the minimum requirements and firm-specific add-ons);

- An RCA that is largely driven by the choices of the resolution authority, as it is meant to implement a particular resolution strategy. Nevertheless, it is not disconnected from the

[93] See Q&A 2015-1824, available at: https://www.eba.europa.eu/single-rule-book-qa.

[94] EBA: CRD IV-CRR/Basel III monitoring exercise (March 2016), particularly Figure 9 (p. 26), available at: http://www.eba.europa.eu/documents/10180/1360107/CRDIV-CRR+Basel+III+Monitoring+Exercise+Report.pdf.

[95] Article 45(6) of the BRRD: 'The minimum requirement for own funds and eligible liabilities of each institution pursuant … shall be determined by the resolution authority … at least on the basis of the following criteria: … need to ensure, in appropriate cases, that the institution has sufficient eligible liabilities to ensure that, if the bail-in tool were to be applied, losses could be absorbed and the Common Equity Tier 1 ratio of the institution could be restored to a level necessary to enable it to continue to comply with the conditions for authorisation … and to sustain sufficient market confidence…'.

[96] Adjustments by the resolution authority are provided for under the RTS to these amounts. Cf. The RTS on MREL.

capital requirements, since the recapitalised institution or receiving entity will need to fulfil minimum capital requirements.

In both cases, the capital requirements encapsulated in the determination are expressed consistently with the CRD/CRR framework—i.e. capital ratios and buffers expressed as a percentage of total risk exposure amount (also known as RWAs) and, where applicable (see the box below) and exceeding those capital ratios, a leverage ratio requirement expressed as a percentage of the leverage ratio exposure.[97]

On the basis of these elements, the resolution authority determines an absolute amount (expressed, for example, in EUR billion) and then translates it (as per the BRRD requirement) into a percentage of TLOF.

In practice, if the legislator takes up the option to express MREL as a percentage of RWAs with a leverage ratio exposure backstop, most of the methodology in the RTS on MREL would remain applicable. Only the last step—i.e. the conversion into a percentage of TLOF—would be discarded. Instead, the resolution authority would convert the amount into a percentage of the RWAs of the institution, as well as a percentage of its leverage ratio exposure. Note that the latter should not be confused with the leverage ratio, from which it would only borrow the denominator as an additional reference base.

When the resolution authority sets the MREL requirement, expressing MREL as a percentage of RWAs and leverage ratio exposure would not change the actual amount of MREL required in nominal value, compared to the current approach where MREL is expressed in terms of TLOF. However, in between two annual MREL decisions, the requirement would evolve with the RWAs of the institution. If the RWAs increased, the nominal value of the institution's MREL would increase. If RWAs decreased, the nominal value of the institution's MREL would decrease but not lower than the requirement expressed as a percentage of the leverage ratio exposure (this would act as a backstop).

Box A: Leverage ratio and leverage ratio exposure – State of play

In December 2010, the BCBS decided to complement the risk-based capital requirement with a leverage ratio requirement.[98] This requirement acts as a non-risk-based measure to: i) constrain leverage in the banking sector, thus helping to mitigate the risk of destabilising deleveraging processes (which can damage the financial system and the economy); and ii) introduce additional safeguards against model risk and measurement error by supplementing the risk-based measure with a simple, transparent measure independent of risk. The BCBS prescribed an observation period from 1 January 2013 until 1 January 2017 during which the leverage ratio, its components and its behaviour relative to the risk-based requirement would be monitored. Based on the results of the observation period, final adjustments to the definition and calibration of the leverage ratio are to be made in the first half of 2017, with a view to migrating to a binding requirement on 1 January 2018.

[97] A third floor is also provided for in the RTS: the 'Basel I floor', as defined in Article 500 of the CRR.

[98] Basel III framework: http://www.bis.org/publ/bcbs189.pdf.

The leverage ratio requirement has been incorporated into European legislation via the CRR/CRD as a new supervisory measure that can be applied to institutions at the discretion of the supervisory authorities. It has also been included as a specific reporting and disclosure obligations for institutions, pending migration to a binding measure in 2018. Leverage is defined in Article 4(1)(93) of the CRR as total on- and off-balance-sheet items compared to that institution's own funds. It is expressed as the following percentage:

$$Leverage\ ratio = \frac{Capital\ measure}{Exposure\ measure}$$

Based on an EBA report published[99] on 3 August 2016 (which recommends a 3% leverage ratio minimum level should generally apply to all credit institutions), the Commission is required to submit a report to the Parliament and the Council by end 2016 on the impact and effectiveness of the leverage ratio, accompanied (where appropriate) with a legislative proposal. It has now done this in the context of its legislative proposals made on 23 November 2016.[100]

ii. Alignment with TLAC and risk-sensitive capital ratios

Capital requirements are currently expressed in terms of RWAs and, where applicable (see Box A), leverage ratio exposure. The FSB TLAC term sheet sets a minimum level of TLAC as a percentage of RWAs (18% from 2022), with a leverage ratio requirement (6.75% from 2022) as a backstop.

A change in the MREL denominator from TLOF to RWAs, with a leverage ratio exposure requirement as a backstop, would therefore be in line with both of these frameworks. This would mean that the number of reference bases for expressing capital, MREL, and TLAC requirements would be reduced from three—(i) TLOF (MREL), (ii) RWAs (CRR/CRD capital requirements and TLAC), and (iii) leverage ratio exposure measure (CRR/CRD capital requirements and TLAC)—to two. This would reduce complexity and would improve comparability among the different ratios and consistency with the current CRR regime, facilitating cooperation and the exchange of information between resolution and supervisory authorities.

For some types of institutions and business models whose total balance sheet size is more volatile than their RWAs, using an RWA denominator for the MREL ratio may reduce the possibility of balance sheet volatility, leading to an MREL requirement that is unstable and particularly more unstable than the institution's capital requirements. Applying RWAs as the denominator would mean that changes in the institutions' RWAs affect capital and MREL requirements at the same time; thus, changes over time would not have a delayed impact on the MREL ratio (i.e. a 'jump' effect when MREL is next set). Institutions' required MREL resources would therefore be more stable. Responses to the EBA's consultation on its draft technical standards on MREL highlighted the instability of average risk weights as a particular concern for financial infrastructure firms that are also licensed as credit institutions, but (in principle) it may also affect other business models—for example, institutions with large, but offsetting, derivative portfolios.

[99] http://www.eba.europa.eu/documents/10180/1360107/EBA-Op-2016-13+%28Leverage+ratio+report%29.pdf.

[100] http://europa.eu/rapid/press-release_IP-16-3731_en.htm?locale=en.

iii. Risk weight variability and the leverage ratio backstop

The use of RWAs as a denominator in the capital framework has raised concerns regarding differences in the calculation of RWAs across institutions and jurisdictions. RWA differences may be caused by differences in business models, asset mixes, risk measurement methodologies, modelling inputs, and supervisory regimes. A series of EBA reports[101] and work by the BCBS[102] have considered the extent to which RWAs might not be calculated consistently, and both authorities have made proposals to mitigate excessive risk weight variability in the capital framework.

Nevertheless, three observations can be made.

First and foremost, the link between capital requirements and MREL remains relevant, and the appropriate place to address differences in RWA calculation is the capital framework. Even using TLOF as a reference base does not alleviate concerns with regard to the determination of RWAs, as capital requirements (expressed using RWAs) are the backdrop for the determination of the MREL loss absorption amount and, in the proportion required by the resolution strategy, the RCA.

Second, the adequacy of institutions' risk modelling approaches may admittedly be a concern in the stressed circumstances likely to accompany a bank resolution. For an institution entering resolution, it is likely that many risks will have crystallised and no longer be suitable for statistical risk modelling. However, it would be difficult to develop an approach to quantify in advance potential changes in an institution's balance sheet as it approaches resolution for the purpose of setting MREL.

Third, the non-risk sensitive leverage ratio has been developed precisely to serve as a backstop against unduly low risk-adjusted capital levels and to prevent the excessive build-up of leverage, both over the financial cycle and across credit institutions. The leverage ratio serves as an additional safety net independent of the risk-based capital requirements that will help prevent excessive levels of debt and, at the same time, protect against the consequences of potential measurement errors and model risks associated with risk-based capital requirements.

If a wholly non-risk sensitive denominator for MREL were still desired, the leverage ratio exposure measure would avoid a number of the disadvantages of the current MREL denominator discussed above. Because it has been developed for the purposes of EU-wide prudential regulation, it has a well-understood and clear definition that can be applied consistently to institutions across the EU and it is already calculated for monitoring purposes.

Finally, regardless of whether a new metric is introduced for the denominator of MREL, the impact of introducing a binding leverage ratio on the level of MREL should be assessed. Indeed, a binding leverage ratio requirement, if set at a high level, may become a driving factor for the determination of the MREL requirement.

[101] See http://www.eba.europa.eu/risk-analysis-and-data/review-of-consistency-of-risk-weighted-assets.

[102] See the two BIS reports analysing variation in RWAs: http://www.bis.org/publ/bcbs256.htm and http://www.bis.org/bcbs/publ/d363.htm.

4.3 Interaction with other provisions of the BRRD

If changes are made to the denominator's definition, this may impact other articles of the BRRD that refer to related metrics. An overview of the most relevant provisions for resolution purposes is provided below.

Article 37(10)(a) of the BRRD

This article provides the possibility of accessing alternative funding sources by using the government stabilisation tools provided for in Articles 56 to 58 of the BRRD. Such recourse is subject to an extraordinary situation of systemic crisis, complemented by a contribution to loss absorption and recapitalisation by shareholders and creditors of at least 8% of TLOF.

Article 44(5)(a) and (b) of the BRRD

Under this article, resolution financing arrangements can make contributions to institutions under resolution. These contributions are, however, subject to a requirement that shareholders and creditors have made a contribution to loss absorption and recapitalisation of at least 8% of TLOF.[103] Such a contribution from the resolution financing arrangement is also limited to 5% of TLOF of the institution under resolution.

All three of these ratios have TLOF as their denominator. They do not include the reference made in the MREL denominator regarding ensuring full recognition of derivative netting rights; however, as they would be evaluated at the time of resolution, it is possible that derivative netting would in fact have occurred at this point.

The EBA has not considered whether a change in metric can be envisaged in this context as well. This issue was considered out of its scope.

Article 102 and 103 of the BRRD

Pursuant to Article 102 of the BRRD, the target level for resolution financing arrangements is based on covered deposits. In contrast, pursuant to Article 103 of the BRRD, the contributions of institutions to these resolution financing arrangements are calculated based on total liabilities (excluding own funds and covered deposits) and the riskiness of each institution. The EBA has recently recommended[104] changing the target level basis for resolution financing arrangements from covered deposits to a measure based on total liabilities (and particularly total liabilities (excluding own funds) less covered deposits). This recommendation was made notwithstanding the issues with the definition of total liabilities noted above, which were also acknowledged in the report on the appropriate target level basis for resolution financing arrangements. This approach would align the reference base used for the target level with the reference base used for the calculation of contributions to those financing arrangements.

Admittedly, a shift in the MREL reference base from TLOF to RWAs and leverage ratio exposure will create a difference in the way MREL requirements and contributions to resolution funds are

[103] Or, under certain additional conditions, 20% of RWAs.

[104] See the report on the appropriate target level basis for resolution financing arrangements, available here.

calculated. Nevertheless, this is not considered problematic, as the two requirements respond to a different internal logic. On the one hand, individual contributions from institutions contribute to a build-up of national and supranational (in the case of the Single Resolution Fund) resolution financing arrangements with the aim of meeting target levels. On the other hand, calibrating MREL is concerned with the assumed loss absorption and recapitalisation needs of a given institution. For the latter, consistency with the reference base used for capital requirements remains essential.

Final recommendations

The EBA recommends that the reference base for the MREL requirement should be changed from TLOF to RWAs. This should be complemented with a leverage ratio exposure backstop requirement, in parallel with its phase-in within the capital framework. This approach achieves alignment with the CRR/CRD regulatory requirements and with the FSB TLAC standard. It also reduces complexity without major substantive changes to the MREL setting process.

If this change is not made, the EBA recommends changing the reference base of MREL from TLOF to the leverage ratio exposure as a more consistently applied non-risk-sensitive measure.

If none of these changes are made, the EBA considers that clarification of the definition of the existing denominator is necessary, either in the Level 1 text or through the introduction of a Level 2 mandate.

5. Relationship between MREL and other regulatory requirements

5.1 Stacking of CET1 buffers

5.1.1 Existing law and implementation

The current treatment of CET1 buffers—the CBR[105]—in the BRRD and the CRD/CRR leads to some contradictions:

- On the one hand, the CRD/CRR framework provides for the creation of buffers in good times in order to reduce the likelihood of an institution running into trouble during economic downturns. Therefore, the CBR should be usable without entry into resolution;

- On the other hand, the BRRD provides for MREL as a minimum requirement that must be met at all times and allows resources used to satisfy the CBR to also satisfy MREL simultaneously.

As a result, the usability of buffers could be affected because using them could lead to a breach of MREL. For example, macroprudential authorities might require that the countercyclical capital buffers be reduced in downturns in the credit cycle, where releasing capital would reduce the risk of the supply of credit being constrained by regulatory capital requirements. If the same CET1 capital can count towards MREL and the CBR, then releasing CET1 from its countercyclical capital buffer might lead the institution to breach its MREL. This creates the risk that the countercyclical capital buffers are less effective as macroprudential tools or, alternatively, that MREL is not a genuinely hard minimum to be met at all times.

Under the FSB TLAC standard, CET1 regulatory capital used to meet minimum TLAC must not be also used to meet regulatory capital buffers[106] (the no double-counting rule). Since the CBR is to be met in addition to the TLAC minimum (i.e. TLAC is a hard minimum to be met at all times, in contrast to the buffers that are designed to be used), this also requires that CET1 capital should first be used to meet TLAC requirements (the priority rule)—i.e. TLAC is stacked below the CBR. Thus, if an institution had insufficient TLAC-eligible debt (either due to a failure to issue enough TLAC-eligible liabilities or due to a failure to roll over maturing TLAC-eligible liabilities) but it had CET1 in its buffers, the CET1 in its buffers would fill its TLAC requirement in priority to its CBR, resulting in a breach by the institution of its CBR.[107] Similar considerations apply to MREL under BRRD; both TLAC and MREL are minimum requirements to be met at all times, and the breach of

[105] Article 128(6) of the CRD. There are three main types of capital buffers for banks: i) the capital conservation buffer (2.5%), ii) the countercyclical buffer (0%-2.5%) and iii) the systemic risk buffer/G-SIB or O-SII buffer (0%-3%). The CBR must be met with CET1 only.

[106] Point 6 of the FSB TLAC term sheet.

[107] Point 6 of the TLAC term sheet provides, in these circumstances, that the automatic restrictions set out in Basel III would apply, mirroring the situation of a failure to roll over maturing Tier 2 instruments. However, for the reasons explained elsewhere in this report, the immediate automatic application of the distribution restriction regime resulting from a buffer breach may not be appropriate in the circumstances of a failure to roll over or issue sufficient MREL-eligible debt.

which should be treated as seriously as a breach of capital requirements. For the remainder of this report, the approach that implements both the no double-counting rule and the priority rule with respect to MREL will be referred to as the stacking order approach.

Another approach could be envisaged that would also achieve the no double-counting rule. Such an approach would entail ensuring that CET1 regulatory capital used to meet minimum MREL cannot be used simultaneously to meet the CBR (the no double-counting rule). However, in contrast to the position in the TLAC term sheet, it would see no priority allocation of CET1 from the buffers to MREL when there is an MREL breach (there would be no priority rule). Instead, the MREL framework would operate as a parallel framework to the CBR framework. Under this approach, if an institution had insufficient MREL-eligible debt but had CET1 in its CBR, that CET1 would not be reallocated to its MREL requirement. Therefore, the institution would breach its MREL requirement. This MREL breach would, in turn, engage the response mechanism of the resolution authority to deal with the MREL breach. For the remainder of this report, this approach—which implements the no double-counting rule but not the priority rule—will be referred to as the parallel framework approach.

In addition, the BRRD and the SRMR feature differences that are not supported by any obvious justification:

- On the one hand, Article 45 of the BRRD is silent on the treatment of the CBR. Under the RTS on MREL, the resolution authority can apply a downward adjustment to the loss absorption amount of MREL if part of the CBR is assessed not to be relevant to the need to ensure that losses can be absorbed in resolution;[108]

- On the other hand, the SRMR states that MREL must be at least equal to minimum capital, including capital buffers.[109]

This contradiction may result in inconsistent implementation of the MREL requirement among Member States. The United Kingdom Prudential Regulation Authority (PRA) has published its policy whereby, in line with the TLAC standard, firms should not count CET1 for the purposes of meeting MREL and capital buffers simultaneously.[110] This would mean that buffers would need to be met separately from MREL. Depending on their business model and liability structure, firms may need to increase financial resources to avoid the double-counting of CET1. The SRB's proposed MREL framework[111] does not include a similar proposal. While this difference need not mean that MREL requirements are more or less strict (as the difference can be taken into account when setting the requirement), it would reduce the comparability of MREL across Member States.

[108] Article 1(5)(ii) of the RTS on MREL.

[109] Article 12(6), last paragraph of the SRMR: 'The minimum requirement for own funds and eligible liabilities referred to in paragraph 4 shall not be inferior to the total amount of any own funds requirements and buffer requirements under Regulation (EU) No 575/2013 and Directive 2013/36/EU.'

[110] http://www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss1616.aspx. The policy will apply to all banks.

[111] https://srb.europa.eu/sites/srbsite/files/20161128_slides_industry_dialogue_mrel.pdf.

5.1.2 Policy options

Five options could be considered with respect to clarifying the interaction between MREL and the CBR in the relevant EU Level 1 texts:

a) Implementation of the stacking order approach for all banks

Under this option, no bank would be able to count CET1 capital towards both the CBR and MREL at the same time. This would mean that, for all banks, the CBR would stack on top of MREL. A failure to have sufficient MREL-eligible debt would result in a breach of the CBR, as CET1 from the CBR was reallocated to MREL. This would achieve the objective of the TLAC standard (usability of buffers) while extending its application to a broader scope of institutions.

b) Implementation of the parallel framework approach for all banks

Under this option, no bank would be able to count CET1 capital towards both the CBR and MREL at the same time. However, the CBR would stack on top of capital requirements only, and not on top of MREL. A failure to have sufficient MREL-eligible debt would result in a breach of MREL, not the CBR. This would also achieve the usability of buffers, but would not achieve the requirement of the TLAC term sheet that buffers stack on top of TLAC.

c) Implementation of the stacking order approach for G-SIBs only

Under this option, G-SIBs would not be able to count CET1 capital towards both the CBR and MREL at the same time. This means that, for G-SIBs, the CBR would stack on top of MREL. In contrast, non-G-SIBs would be able to continue to use CET1 capital to meet the CBR and MREL simultaneously. This option would implement the TLAC standard to the letter.

d) Implementation of the parallel framework approach for G-SIBs only

Under this option, G-SIBs would not be able to count CET1 capital towards both the CBR and MREL at the same time. However, there would be no priority allocation of CET1 from the CBR to MREL for G-SIBs. In contrast, non-G-SIBs would be able to continue to use CET1 capital to meet the CBR and MREL simultaneously. This would also achieve the usability of buffers for G-SIBs, but would not achieve the requirement of the TLAC term sheet that buffers stack on top of TLAC.

e) Double-counting for all banks

Under this option, the CET1 capital used to meet the CBR may be used by all banks to meet MREL. The RTS on MREL allows for the resolution authority to make adjustments to MREL, taking into account, inter alia, the CBR. This is currently the status quo in the Banking Union, as provided for in the SRMR and the RTS on MREL. This approach does not address the usability of buffers, runs contrary to the TLAC standard, and undermines MREL as a minimum requirement that must be met at all times.

5.1.3 Considerations when choosing the preferred option

- *Clarity and consistency across Member States*

Regardless of the option for the stacking of the CBR ultimately adopted, it is important to ensure that the interaction between MREL and the CBR is clear in the relevant EU Level 1 texts to avoid ambiguity in interpretation and divergent approaches being taken by Member States. In particular, any Level 1 difference between the Banking Union Member States and non-participating Member States should be duly justified.

- *Harmonisation with international standards*

The FSB TLAC standard for G-SIBs allows only CET1 in excess of that required in order to satisfy the minimum regulatory capital and minimum TLAC requirements to count towards regulatory capital buffers. The TLAC term sheet also states that automatic distribution restrictions will be applied where there has been a failure to have sufficient TLAC-eligible debt, requiring CET1 from the buffers to be used.[112] The Commission has committed to implementing the TLAC standard in the EU. In light of this, keeping double-counting for G-SIBs or failing to stack the CBR on top of MREL would result in the EU deviating from the internationally agreed standard.

- *Impact on MREL financing needs*

Without offsetting changes in the calibration of MREL requirements, preventing double-counting could increase banks' MREL financing needs. However, this consequence can be avoided by lowering, in the same proportion, the calibration of MREL levels to take into account the elimination of double-counting by reducing the default loss-absorbing amount.

- *Purpose of capital buffers*

The purpose of the CBR is to allow for it to be drawn on by the bank in periods of stress.

In order to have capital buffers function as intended, authorities could implement alternative methods leading to different national approaches, particularly with respect to intervention regimes. This may affect the EU level playing field, as well as lead to unintended cross-border complications (e.g. if an MREL breach is treated differently across EU Member States).

Preventing double-counting would create a clear intervention mechanism for when buffer requirements are breached, which would be separate from any response due to a breach of the MREL requirement.

- *Restrictions on voluntary distributions*

The CBR must be met by a bank if that bank is to be permitted to make discretionary distributions—i.e. the payment of dividends on CET1 instruments, or the payment of coupons on AT1 instruments, variable remuneration or discretionary pension benefits. The restriction on the making of distributions when a bank's capital falls within the CBR is not an absolute prohibition on distributions. Instead, a bank will, in such instances, be required to calculate its MDA. This will be

[112] Point 6 of the TLAC term sheet.

the bank's distributable profits, calculated in accordance with the CRD formula, multiplied by a factor (between 0.0 and 0.6) depending on how short of the CBR the bank's CET1 falls.

Adopting the stacking order approach under which capital buffers would be stacked on top of MREL could mean that a CBR breach—de facto triggering the application of automatic restrictions on distributions—could happen at higher levels of capital than is currently the case. Admittedly, this would only be the case when banks choose to meet a significant part of their MREL requirements through own funds rather than eligible liabilities. Nevertheless, it would also mean that automatic distribution restrictions could be triggered even where an institution's capital position is impacted due to losses suffered.

Although institutions should maintain an appropriate maturity profile of MREL-eligible liabilities, an automatic restriction on distributions could also occur involuntarily if banks are unable to issue or refinance maturing MREL-eligible liabilities due to idiosyncratic or market-wide stresses. Therefore, the interaction between the stacking of capital buffers and MREL on the one hand and the rules surrounding MDA restrictions on the other hand needs to be carefully considered. Changes could be introduced to the current manner in which the MDA framework operates if the stacking order approach were to be adopted. Section 5.2 below sets out the EBA's considerations in that regard.

- *Heterogeneity of EU banking sector*

The EU banking sector is heterogeneous, with many different business models and structures. It may not be appropriate to apply the same requirements to G-SIBs as to all other institutions. Due to the different degrees of access to capital markets, some smaller institutions may find it more difficult to meet any resulting increase in MREL requirements through instruments other than capital. On the other hand, having a separate regime for G-SIBs and other institutions may increase complexity and create confusion.

- *Complexity and stability of the framework*

Both the stacking order approach and the parallel framework approach entail implementing changes to legislation. The stacking order approach has knock-on implications for the MDA framework and requires possible consequent changes to that framework. The overall regulatory framework risks becoming more complex and more opaque to investors and the market depending on the additional changes made to it. In addition, stability of the framework for banks and market participants is an important consideration.

- *Consistency between supervision and resolution*

The parallel framework approach entails treating the CBR framework as a separate matter from the MREL framework, with CET1 allocated to the CBR being reserved for the CBR and not being reallocated to MREL in the event of a failure to roll over or issue MREL-eligible instruments. However, the failure to roll over or issue such instruments and a resulting breach of minimum requirements is a significant event for an institution. It should therefore entail a supervisory response and not just a resolution authority response. Treating the two matters as entirely separate and parallel may not be appropriate.

- *Restoration of compliance with regulatory requirements*

At present, the breach of the CBR by an institution triggers the requirement for an institution to propose and implement a capital conservation plan under Article 142 of the CRD. Under the stacking order approach, an institution could breach its CBR as the result of a failure to roll over or issue MREL-eligible debt, requiring it to use CET1 from its CBR to meet its MREL requirement. The appropriate response to such a failure should be carefully considered.

5.1.4 Assessment of available options

It is clear that the usability of buffers should be preserved, and the current legislative framework does not allow for this. Therefore, a change in the framework is needed to implement either the stacking order approach or the parallel framework approach. Introducing either approach would improve clarity and consistency across Member States. In addition, non-G-SIBs can be subject to buffer requirements, and therefore the proposed regime should cover both G-SIBs and non-G-SIBs; the rationale of preserving the usability of the buffers is the same in both cases. The merits of each approach should be carefully assessed.

Stacking order approach

This option complies with the requirements of the TLAC term sheet by ensuring that CET1 in the CBR cannot be double-counted towards MREL and that, in the event of a failure to roll over or issue sufficient MREL-eligible debt, CET1 from the buffers is reallocated to meet the MREL requirement.

The approach appropriately maintains the interaction between resolution and supervision—a failure to roll over or issue sufficient MREL-eligible instruments is a significant event for an institution and should be treated as such by both resolution authorities and competent authorities.

The TLAC term sheet also prescribes that a breach of TLAC should be treated as seriously as a breach of going concern capital requirements. The engagement of the MDA regime is therefore appropriate. A breach of the CBR also creates a requirement for a capital conservation plan at present. More appropriate response mechanisms could be considered in these circumstances, as set out in Section 5.2 below.

However, at present, this would result in a breach of the CBR and the application of MDA restrictions. Careful consideration should therefore also be given to implementing changes to the MDA regime to deal with this issue.

In addition, there should be appropriate interaction between the competent authority and resolution authority regarding any response to such a breach.

Parallel framework approach

This approach prevents the automatic engagement of the MDA framework due to the failure to roll over or issue sufficient MREL-eligible debt. It also requires fewer consequent changes to

implement. However, the option does not comply with the TLAC term sheet, which requires the CBR to stack on top of TLAC. It also separates supervisory issues and resolution issues, as well as risk authorities acting only in relation to their own requirements without assessing the bank's issues in an appropriately holistic manner. Furthermore, it may be inappropriate to have a bank breaching a minimum requirement (MREL) while the bank has sufficient CET1 to meet the buffer requirements and can therefore continue to make discretionary distributions. Buffers are meant to be used on a going concern basis when a firm is in stress, and MREL is part of the gone concern framework. The parallel framework approach blurs the line between the going and gone concern regimes, and risks undermining the intent of buffers and MREL.

Final recommendations

The EBA recommends that, in principle, the usability of regulatory capital buffers would be best preserved if CET1 in the CBR could not also count towards meeting the MREL requirement. Therefore, banks in the EU should not be able to use the same CET1 capital to meet MREL and also meet regulatory capital buffers.

The EBA's view is that the stacking order approach (under which the buffers are stacked on top of MREL) should be implemented since it is in compliance with the TLAC term sheet and treats MREL and capital requirements in a contiguous and integrated manner. Nevertheless, careful consideration should be given to the interaction of the stacking order approach with automatic MDA restrictions on voluntary distributions, and the need for a capital conservation plan. This is particularly relevant for banks that rely mainly on capital instruments to meet MREL due to limited or no access to debt capital markets, including international markets. Therefore, the additional recommendations on the interaction of MREL and the MDA regime made in this report should also be adopted.

On the other hand, if the parallel framework approach were to be adopted (under which the buffers stack on top of minimum capital requirement only, and not MREL), the provision for resolution authorities regarding an appropriate toolkit to deal with MREL breaches would become even more important.

5.2 Interaction between MREL and the MDA framework

If the stacking order approach described above is adopted, there are important interactions with the existing regulatory buffer requirements that need to be taken into account. By stacking the CBR above MREL, if the institution fails to roll over or issue sufficient MREL-eligible debt, then excess CET1 (not yet counted towards Pillar 1 or Pillar 2) would be automatically reallocated to MREL. This, in turn, may lead to a breach of the institution's CBR.

The different buffers that make up the CBR are designed to be used for specific purposes. In principle, the breach of the CBR does not prompt intrusive supervisory measures. This contrasts with a breach of Pillar 1 and/or Pillar 2 minimum capital requirements. However, the breach of

the combined buffer should be only temporary and, to that effect, banks need to implement a capital conservation plan in accordance with Article 142 of the CRD to restore capital levels above this requirement.

At present, upon breaching the CBR, banks face automatic distribution restrictions in relation to CET1, Additional Tier 1 (AT1) instruments and variable remuneration as determined by the MDA framework. In other words, adopting the stacking order approach set out above would mean that restrictions might be triggered at higher CET1 levels than is currently the case or might arise from a failure to roll over or issue sufficient MREL-eligible debt rather than any specific erosion in the level of CET1 that composes the CBR.

5.2.1 The existing MDA framework's response as inappropriate

The application of automatic restrictions on distributions under the MDA framework may not be appropriate in all circumstances, where there is a breach of an institution's CBR arising from a failure to roll over or issue sufficient MREL-eligible debt for instance due to volatile market conditions.

The TLAC term sheet asserts[113] that the failure to roll over TLAC-eligible instruments is equivalent to a failure to roll over a Tier 2 capital instrument (in terms of its interaction with the CBR) and thus it should trigger automatic distribution restrictions. However, there are conceptual differences between going concern capital and gone concern capital that may justify a difference in the treatment of distribution restrictions in this scenario. Distribution restrictions may be appropriate, but arguably they should not be automatic or immediate, and should be one of a suite of measures available to the authorities to address a breach of the CBR from the failure to roll over or issue sufficient MREL-eligible debt.

Conceptually, the purpose of MDA restrictions is to ensure that capital in the buffers is restored from the earnings of the institution before any discretionary distributions are made to employees, shareholders, or the holders of capital instruments. However, when it comes to situations where a breach of the CBR is not due to a reduction in the levels of CET1 in the institution, but rather the institution has failed to roll over or issue sufficient debt to meet its MREL requirement, the ability of restrictions to achieve the purpose described above must be assessed:

- On the one hand, where there has been a failure to roll over or issue sufficient MREL-eligible debt, enhanced supervisory and resolution authority engagement and measures are appropriate. It may also be appropriate that the capital position of the institution be strengthened and, in that regard, automatic restrictions on distributions remain valid. Being unable to roll over or issue sufficient MREL-eligible debt due to idiosyncratic reasons (as opposed to market-wide turbulence) can be a sign of liquidity problems for the bank, with possible far-reaching consequences in terms of viability in the short term. In this context, preventing additional outflows via the restriction of distributions is also particularly relevant. The possibility of triggering automatic distribution restrictions also remains a useful incentive mechanism to ensure that institutions monitor and maintain their MREL stack.

[113] Point 6 of the TLAC term sheet.

- On the other hand, it may not always be appropriate to automatically restrict distributions where there has been no reduction in the levels of CET1 in the institution and an institution failed to roll over or issue sufficient debt (for instance, due to general market turbulence rather than the idiosyncratic position of the institution itself). In such a situation, a restriction of payments on debt coupons could actually be counterproductive because it could exacerbate MREL-eligible debt issuance difficulties (as investors could be discouraged from buying new instruments). Furthermore, the MDA framework was designed for a different purpose—the preservation and restoration of capital in the context of the CBR—and it may not be appropriate for it to trigger immediately as a result of a failure to roll over or issue sufficient MREL-eligible debt (which should be remedied by attempting to issue or reissue MREL-eligible debt).

In light of the foregoing, it may be appropriate that, where an institution breaches its CBR due to the failure to roll over or issue sufficient MREL debt, it be given a grace period before MDA restrictions are triggered. During this grace period, it can attempt to issue or reissue MREL-eligible debt to remedy the CBR breach. The activation of this grace period could be automatic or discretionary and dependent on the reason for the failure to roll over or issue sufficient MREL-eligible debt. These recommendations can function on a stand-alone basis or feed into a wider evaluation of the MDA framework.

5.2.2 MDA and MREL – The need for delayed automaticity in restrictions

In order to mitigate the risk of the MDA triggering as the result of a failure to roll over or issue sufficient MREL-eligible debt, it could be envisaged that there would be a delay in the automatic triggering of MDA restrictions where the breach is due to the failure to roll over or issue sufficient MREL-eligible instruments. This would provide an institution with time during which it could attempt to remedy the breach by issuing or reissuing MREL-eligible debt.

The grace period envisaged could be triggered automatically or could be an option for the authorities to invoke on a discretionary basis, having considered the reasons for the failure to roll over or issue sufficient MREL-eligible debt that led to the breach of the CBR.

- Automatic grace period

  Under this approach, when the CBR is breached as a result of a failure to roll over or issue sufficient MREL-eligible debt, there would be no restrictions under the MDA regime for a defined period of time. If, at the end of that defined period of time, the institution is still in breach of its CBR, it would then be subject to MDA restrictions. There are a number of benefits to this approach. It preserves the automatic nature of the MDA regime, introducing the automatic suspension of distribution restrictions rather than relying on supervisory or resolution authority assessments. This has the substantial benefit of removing uncertainty for the market and banks. It would also be relatively quicker and simpler for the authorities to enact. However, it would mean that the automatic suspension of restrictions occurred in all cases of a failure to roll over or issue sufficient MREL-eligible debt, which would not take into account the reason for the failure. In some cases, it may still be appropriate for restrictions to trigger automatically (i.e. for no grace period to be granted). This may be the case where, for

instance, the failure to roll over or issue sufficient debt results in an actual breach of MREL notwithstanding the reallocation of CET1 from the buffers. Therefore, it would need to be clear that the grace period was without prejudice to the general power of the competent authority to impose distribution restrictions on an ad hoc basis and any other response that the authorities may undertake. A suspension of automatic distribution restrictions would not mean that distribution restrictions could not be imposed even during the grace period if deemed necessary.[114]

- Discretionary grace period

  In contrast, a discretionary grace period could be envisaged under which automatic distribution restrictions would remain the default response to a breach of the CBR but the authorities would have the discretionary ability to suspend distribution restrictions for a defined period of time. The use of this discretion could be based on the reasons for the failure to roll over or issue sufficient MREL-eligible debt (e.g. market-wide closure rather than the idiosyncratic situation of the institution) and/or on the severity of the failure to roll over or issue (e.g. quantum of debt not rolled over or issued, the likelihood of a worsening breach, the size of the market for the institution's MREL-eligible debt, etc.). If this approach were adopted, it would be important that the circumstances in which the discretion arose and the process for using it (i.e. which authority makes the decision, how they interact with other authorities) would be carefully specified, with additional details on technical points (potentially reserved to technical standards). The benefit of this approach is that it preserves the automaticity of the MDA regime as a default, but allows for the possibility of MDA restrictions to be suspended in the appropriate circumstances. However, the approach also has substantial drawbacks that would need to be addressed in the proposal—in particular, the introduction of discretion could be opaque for investors and the market, and complicated for the authorities to enact within an appropriate period of time. It also has a potentially undesirable signalling effect for the market, which would attempt to deduce something about the financial health of the institution depending on whether or not the discretion to suspend distribution restrictions was exercised or not.

Regardless of whether the grace period is automatic or discretionary, consideration also needs to be given to the appropriate length of any such grace period. The period would need to be sufficiently long to allow the institution to have a realistic opportunity to issue or reissue MREL-eligible debt to restore its buffers. On the other hand, it should not be so long as to allow further damage to the loss-absorbing capacity of the institution or to delay the response of the authorities. The regime could also allow authorities to extend the grace period on a discretionary basis, with regard to the circumstances of the case.

During the grace period, heightened supervisory and resolution authority engagement with the institution could be envisaged. The authorities would have a good idea of the ability of the institution to issue (or not) new MREL-eligible instruments during the grace period, and they would be prepared to act as soon as the time expired (or before, if necessary) in cases where the institution appeared incapable of issuing or reissuing MREL-eligible instruments to restore its CBR.

[114] Articles 102 and 104 CRD are relevant in that regard.

Where there has been an actual breach of MREL (meaning that, in spite of reallocating the CET1 used for buffers towards MREL, the MREL requirement is still not met), the specific powers available in order to address MREL breaches would also be available.

It is crucial that there is appropriate interaction and engagement between the competent authority and resolution authority. In particular, the authorities should proactively monitor the maturity profile of institutions' MREL-eligible and TLAC-eligible liabilities. Where an authority becomes aware (through this monitoring) that an institution will imminently need to use the CET1 in its CBR to continue to meet its MREL requirements unless it is able to issue further MREL-eligible debt and it reasonably believes that the institution will not be able to issue such debt, it should notify the other authority of this prospective breach by the institution of its CBR as soon as possible.

Finally, it is also crucial that the market and investors are sufficiently well informed about the framework and the existence of any discretion in it in order to be able to make appropriate risk and investment decisions. Therefore, the possibility that an institution may breach its CBR and be subject to MDA restrictions as the result of a failure to roll over (otherwise unrelated) MREL-eligible instruments should be clear to investors in relevant instruments. Furthermore, the general disclosure requirements discussed in Section 9 below should also take into consideration this issue.

5.2.3 Response mechanism to the failure to roll over leading to a CBR breach

An appropriate response mechanism needs to be provided to authorities where a failure to roll over or issue sufficient MREL-eligible debt does not result in a breach of the MREL requirement, but does result in the CBR being breached as CET1 drops down from the buffers into MREL. In addition to breaching its CBR, it is also important to note that, in these circumstances, the composition of the institution's MREL will have changed (debt instruments will have been replaced by CET1 from the buffers). This may also need to be addressed by the response mechanism of the authorities.

At present, the breach by an institution of its CBR triggers the need for a capital conservation plan under Article 142 of the CRD. This capital conservation plan assumes that the breach of the CBR results from a depletion of capital, and thus the competent authority interacts with the institution in relation to this plan.

If the stacking order approach is implemented, a breach of the CBR would also be possible due to the failure to roll over or issue sufficient MREL-eligible debt. Therefore, the need for a capital conservation plan should not be triggered when the CBR is breached due to a failure to roll over or issue sufficient MREL-eligible debt, since capital conservation is not the issue but rather the need for the institution to issue or reissue MREL-eligible debt. In these circumstances, it could be envisaged that an MREL conservation plan (analogous to a capital conservation plan) would be required from the institution. In this plan, the institution should clearly set out how it intends to remedy the breach of its CBR by issuing or reissuing MREL-eligible liabilities, modifying existing liabilities to make them MREL-eligible, or otherwise altering its balance sheet in order to have sufficient MREL-eligible liabilities so that it does not need to rely on CET1 from the CBR to meet its

MREL requirement. The power to approve such a plan should rest with the resolution authority. However, since the execution of the MREL conservation plan would restore the institution's compliance with the CBR, the resolution authority should be required to consult the competent authority when assessing the plan proposed by the institution. A clear time limit (e.g. 72 hours) should be provided for a response from the competent authority in these circumstances, to ensure that sufficiently prompt action can be taken to address the issue.

If the resolution authority (in consultation with the competent authority) is not satisfied with the plan proposed, the resolution authority should have the power to request additional issuance or otherwise require the institution to restore both the quantum and composition of its MREL stack. In this regard, the resolution authority could use the powers proposed in Section 5.4 below in relation to the maturity profile of the institution. Where the authorities do not believe that the plan proposed by the institution is credible in terms of remedying the CBR breach, the breach could be said to constitute an impediment to the resolvability of the institution (i.e. the institution is relying on going concern capital from the CBR to meet a gone concern requirement) and this would allow the resolution authority to use its impediment removal powers in relation to MREL. If the plan fails to restore the CBR of the institution within the grace period, the institution would become subject to distribution restrictions under the MDA regime. The resolution authority would continue to engage with it (consulting the competent authority as necessary) to ensure that it can meet its MREL requirement and the CBR, including through altering/updating the MREL conservation plan and using impediment removal powers.

Final recommendations

The EBA recommends that competent authorities and resolution authorities should be required to inform each other of potential breaches of capital or MREL requirements as they become aware of them through their respective monitoring processes.

To the extent that the stacking order approach is adopted, the legislative framework should introduce a suspension in the automatic triggering of distribution restrictions under the MDA framework where the breach relates to a failure to roll over or issue sufficient MREL-eligible debt. This suspension could either arise automatically or on a discretionary basis following consideration of the circumstances by the authorities. In both cases, the length of the grace period should be clearly specified and possibly be subject to a renewal decision by the authorities.

There should be heightened supervisory and resolution authority engagement with the institution during the grace period. If the institution has been unable to issue or reissue MREL-eligible debt to restore the CET1 in its CBR at the end of the grace period, the MDA framework response would then apply.

The provisions of Article 142 of the CRD should be updated to ensure that the need for a capital conservation plan is not triggered by a breach of the CBR arising from the failure of an institution to roll over or issue sufficient MREL-eligible debt. Instead, in these circumstances, an MREL conservation plan should be required in which the institution would specify how it would restore compliance with its CBR. The adequacy of the MREL conservation plan should be assessed by the

resolution authority in consultation with the competent authority. If the plan is deemed to be inadequate, the resolution authority should be able to use its impediment removal powers to address the institution's breach of its CBR on the basis that an impediment to resolvability is created by the institution (by using going concern capital from its CBR to meet a gone concern MREL requirement).

Finally, the possibility that an institution may breach its CBR and be subject to MDA restrictions as a result of a failure to roll over (otherwise unrelated) MREL-eligible instruments should be clear to investors in relevant instruments. Furthermore, the general disclosure requirements discussed in Section 9 below should also take this issue into consideration.

5.3 Consequences of a breach of MREL

MREL represents a minimum regulatory standard that is to be met by institutions at all times. It is similar, in that regard, to regulatory capital requirements. As a result, a breach of MREL must be treated in no less serious a manner than a breach of capital requirements. The authorities should have appropriate tools available to respond to such a breach. In addition, both competent authorities and resolution authorities may have a role in responding to such a breach—depending on the nature of that breach—and it is crucial that they cooperate and coordinate their responses.

5.3.1 Current powers to address a breach of MREL

Under the FSB standard, if a firm exhausts its regulatory capital buffers and has breached or is likely to breach TLAC, authorities should require the firm to take prompt action to address the breach or likely breach. Authorities must ensure that they intervene and place a firm into resolution sufficiently early if it is deemed to be failing or likely to fail and there is no reasonable prospect of recovery.

While the BRRD is clear that MREL is a minimum requirement that must be met at all times,[115] it does not contain specific provisions covering the implications of an MREL breach. In this context, at least four courses of action could be envisaged under the current BRRD provisions:

(i) A breach of MREL could be dealt with by the resolution authority as part of its powers to address or remove substantive impediments to resolvability. The resolution authority has the power to either require an institution to issue eligible liabilities to meet MREL[116] or require an institution to take other steps, including (in particular) attempting to renegotiate any eligible liability, AT1 or Tier 2 instrument it has issued to meet MREL.[117]

[115] Article 45(1) of the BRRD.

[116] Article 17(5)(i) of the BRRD.

[117] Article 17(5)(j) of the BRRD.

However, these powers do not enable immediate action and there is a lengthy process required before the resolution authority is able to make use of them. Indeed, requirements to remove impediments to resolvability can be imposed only on the basis of an assessment of resolvability (usually an annual process) after allowing 4 months for the institution concerned to make proposals on how to remove the impediment and (for cross-border banks) after involving the college. This may not allow for a sufficiently prompt response to a breach of a minimum requirement.

Moreover, these powers are linked to 'substantive' impediments without this 'substantive' character being defined in the BRRD, potentially creating an unnecessary legal risk or hurdle for the authorities in using such powers.

(ii) Additional powers may implicitly be available to resolution authorities—for instance, to request institutions to submit a plan to restore compliance with MREL. In addition, pursuant to Article 110 of the BRRD, Member States are required to attribute to resolution authorities or (depending on the infringement) competent authorities powers to impose administrative penalties and measures where the national provisions implementing BRRD have not been complied with. Member States may decide not to lay down rules for administrative penalties for infringements that are subject to national criminal law. Nevertheless, a breach of MREL is not one of the mandatory situations set out in Article 111 of the BRRD for which administrative penalties (or equivalent criminal law provisions) must be available. The existence of these additional powers is unclear, or is a matter for national law. In the interests of the harmonisation of the response to an MREL breach, greater clarity is desirable.

(iii) Action may also be taken by competent authorities. The EBA Guidelines on triggers for the use of early intervention powers by competent authorities[118] identify a significant deterioration in MREL as a significant event that may trigger consideration of early intervention actions. Such measures could include, for example, implementing actions outlined in the institution's recovery plan or requiring a plan to negotiate the restructuring of debt.

(iv) A breach of MREL may be a matter taken into account by the competent authority (or, where so empowered, the resolution authority) when undertaking a failing or likely to fail assessment, insofar as it coincides with the capital or liquidity circumstances such as those referred to in Article 32(4) of the BRRD and considered in the EBA Guidelines on failing or likely to fail.[119] In cases where there is a severe, persistent and/or worsening breach of MREL—for example, where the institution is not able to roll over a substantial part of its MREL-eligible liabilities, authorities should

[118] Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU, EBA/GL/2015/03, 28 July 2015, available at: https://www.eba.europa.eu/documents/10180/1151520/EBA-GL-2015-03_EN+Guidelines+on+early+intervention+measures.pdf/9d796302-bbea-4869-bd2c-642d3d817966.

[119] Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU, EBA/GL/2015/07, 26 May 2015, available at: https://www.eba.europa.eu/documents/10180/1085517/EBA-GL-2015-07+GL+on+failing+or+likely+to+fail.pdf/02539533-27ed-4467-b442-7d2fa6fcb3d3.

be able to take this into account in these assessments. This is consistent with the rationale that MREL is a minimum requirement that must be met at all times. Any such assessment would, as in all cases, need to be undertaken in a proportionate way and taking into account the conditions set out in Article 32(4) of the BRRD. The assessment should also take into account the requirement that resolution should be triggered only when there is no reasonable prospect of alternative private sector measures being successful, in order to ensure that temporary breaches of MREL that can be addressed by the institution do not trigger resolution. In this regard, Recital 41 of the BRRD provides that '*the fact that an institution does not meet the requirements for authorisation would not justify per-se the entry into resolution if the institution is still or likely to be still viable*'.

Therefore, at present, resolution authorities have powers to deal with an MREL breach that are too slow (impediment removal), too uncertain (administrative penalties, implicit restoration plan requirements, or failing or likely to fail assessment) or available only to another authority (early intervention). This situation creates practical enforcement problems for resolution authorities. In addition, it is not in conformity with the requirements of the TLAC term sheet.[120]

At present, the ability of a resolution authority to respond to a breach of MREL can be contrasted with the ability of a competent authority to respond to a breach of minimum capital requirements. Both the CRD and the BRRD provide the competent authority with a wide range of powers to take measures where an institution fails to maintain capital requirements.

The CRD[121] allows competent authorities to take action at an early stage to address problems an institution has, or may have, in meeting its own funds requirements or the CBR. Such actions include capital add-ons, specific provisioning, reduction of inherent risk, restrictions on business, blocking of dividends, or additional reporting and/or disclosures. Furthermore, Article 18(d) of the CRD provides that authorisation may be withdrawn when an institution no longer meets its Pillar 1 or Pillar 2 capital requirements.

The BRRD[122] establishes early intervention powers that must be available to competent authorities when an institution infringes—or is likely, in the near future, to infringe—CRD or CRR requirements. These powers include the ability to dismiss management and appoint a temporary administrator, as well as to convene a meeting of shareholders to adopt urgent reforms and require the institution to draw up a plan to negotiate with its creditors the restructuring of its debt. In addition, Article 32(4)(a) of the BRRD provides that an institution shall be deemed to be failing or likely to fail if it infringes—or may, in the near future, infringe—the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority, including because the institution has incurred, or is likely to incur, losses that will deplete all or a significant amount of its own funds.

[120] Principle 10 of the FSB TLAC term sheet states that 'a breach or likely breach of minimum TLAC should be treated as severely as a breach or likely breach of minimum capital requirements and addressed swiftly, to ensure that sufficient loss-absorbing capacity is available in resolution'.

[121] Articles 102 and 104 of the CRD.

[122] Article 27 of the BRRD.

5.3.2 Proposed powers to address a breach of MREL

Resolution authorities need to be given enhanced powers to address breaches of MREL. These powers should allow for a graduated response, with the severity of the power used dictated by the circumstances surrounding (and nature of) the breach to which it is responding. Automatic consequences should be avoided to allow for a response that is appropriately tailored to each breach. The powers must allow the resolution authority to repair the loss-absorbing capacity of the institution within an appropriate time frame. In light of these considerations, a number of additional or modified MREL breach response powers are proposed for the resolution authority.

MREL restoration plans

Where there is a failure to roll over MREL-eligible debt (and a consequent MREL breach), an appropriate response may be for the resolution authority to request an MREL restoration plan, analogous to a capital restoration plan under Article 104(1)(c) of the CRD. Resolution authorities should have the explicit power to require an institution to produce and implement an MREL restoration plan that would set out how it intends to deal with a breach of MREL by repairing its loss-absorbing capacity. There should be clear consequences for an institution that fails to produce an adequate MREL restoration plan. The involvement of the competent authority in any MREL restoration plan process should be clearly specified.

An MREL restoration plan should be an adequate and credible plan for how the institution intends to repair its loss-absorbing capacity. The plan may specify, for instance:

- That the institution will issue new MREL-eligible instruments either in the form of capital or debt;
- That it will attempt to renegotiate existing liabilities to make them eligible for MREL;
- That it will otherwise restructure its balance sheet to ensure that it meets its MREL requirement.

The adequacy of the plan should be assessed with regard to factors that could include the depth of the market for the institution's MREL-eligible instruments, the pricing of its existing MREL-eligible instruments, the strength of its financial performance and position, and the time needed to execute any restructuring transactions proposed. The resolution authority should consult the competent authority before concluding any assessment of the adequacy of an MREL restoration plan.

If the MREL restoration plan is assessed as inadequate, the resolution authority should have clearly defined response powers to address the situation. Such powers could include those set out in more detail below: the power to require the removal of impediments on an expedited basis; and the power to request the restriction of distributions.

Additional considerations arise under the stacking order approach. Under that approach, an MREL breach will, by definition, occur at the same time as the total depletion of the CBR, since the CET1 from the CBR will have been reallocated to MREL. At present, this depletion would trigger

automatic MDA distribution restrictions and the need for a capital conservation plan under Article 142 of the CRD. However, under Section 5.2 of this report, the stacking order approach would imply the following changes:

- Where the breach of the CBR occurs as the result of a failure to roll over or issue sufficient MREL-eligible debt, a grace period should be introduced before MDA restrictions are triggered. This grace period could be either discretionary or automatic:

    - If it is discretionary, it is highly likely that the discretion to suspend automatic distribution restrictions would not be exercised where there is also an MREL breach (i.e. the reallocation of CET1 from the buffers has still been insufficient to allow the institution to meet its MREL requirement). Therefore, MDA distribution restrictions would apply to the institution;

    - If the grace period is automatic, delaying distribution restrictions where there is also a breach of MREL is likely to be inappropriate. There is an argument that there should be no automatic suspension of MDA distribution restrictions where there is an actual breach of MREL. Alternatively, if there is still an automatic suspension of distribution restrictions, the resolution authority should be able to use its power to request that an ad hoc restriction of distributions is imposed by the competent authority (see below) even during the grace period;

- Where the breach of the CBR occurs as the result of a failure to roll over or issue sufficient MREL-eligible debt, an institution should be required to come up with an MREL conservation plan rather than a capital conservation plan. However, where there is an actual breach of MREL (notwithstanding the reallocation of CET1 from the CBR), there should be no need for an MREL conservation plan—an MREL restoration plan should suffice. Both are essentially the same type of plan and are attempts to achieve the same end. An MREL conservation plan is used where a failure to roll over or issue sufficient MREL-eligible debt results in a breach of the CBR, while an MREL restoration plan is used where the failure to roll over or issue sufficient MREL-eligible instruments results in a breach of both the CBR and MREL.

Expedited impediment removal power

In addition to the power to request an MREL restoration plan from the institution, the resolution authority has existing powers under the framework of the removal of impediments that can be used. The failure by an institution to maintain sufficient gone concern loss-absorbing capacity could certainly be considered an impediment to resolvability. This report also recommends that the resolution authority should have stronger powers related to specifying the maturity profile and issuance of MREL-eligible debt by the institution. Such powers are already described below in relation to maturity monitoring and they should also be available in the event of a breach of MREL (along with other measures for addressing impediments to resolution) where the resolution authority is not satisfied with the proposed MREL restoration plan or that plan is failing to restore the institution's MREL profile at an appropriate rate.

At present, the removal of impediments process (as set out in Article 17 of the BRRD) takes a significant amount of time, involving engagement with the institution and—in the case of cross-border institutions not wholly located in the Banking Union—with the resolution college. It would be appropriate, in circumstances where the impediment in question is the failure by the institution to meet its MREL requirement, to provide for an expedited process of engagement with the institution and with the resolution college. In particular, the latter is justified by the fact that the members of the college have previously agreed to the MREL requirement for the institution, and therefore the time needed to consult them on measures to ensure compliance with the agreed MREL requirement should be shortened. Nevertheless, the core elements of the process (engagement with the institution, engagement with the college where relevant, and engagement with the competent authority) should remain intact—the only change should be the length of time each actor has to respond to the issue before the resolution authority can activate its own impediment removal powers.

Restriction of distributions

Distribution restrictions may be appropriate in the context of an MREL breach, depending on the approach that the resolution authority considers best for the institution to restore its MREL. This is particularly the case if the parallel framework approach is adopted, since, under this approach, the automatic restrictions in the MDA regime would not be engaged by a breach of MREL (as MREL would not interact with the CBR). Distribution restrictions may be counterproductive to the institution issuing MREL-eligible instruments to repair its loss-absorbing capacity, but they may be appropriate for the institution to preserve its capital position to the extent possible—the resolution authority will be best placed to judge this holistically in the context of the MREL restoration plan it has approved or other actions it has taken. Therefore, the resolution authority should be given the power to request that the competent authority uses its existing power to restrict distributions under Article 104 of the CRD. The response of the competent authority to this request should be fully reasoned.

Joint restoration plan

In certain circumstances, as set out in Section 5.3.3 below, there might be a need for a joint restoration plan to be adopted by the resolution authority and competent authority, in which the institution would set out how it will address both a breach of minimum capital requirements and a breach of MREL. There should be an explicit power to request and approve such a plan. The plan should clearly distinguish between those parts aimed at addressing the capital breach, those parts aimed at addressing the MREL breach, and those parts aimed at addressing both issues.

5.3.3 Interaction between the resolution authority and the competent authority

MREL interacts with an institution's minimum regulatory capital requirements, as an institution may also count some (or all) of the instruments it uses to meet its minimum regulatory capital requirements towards its MREL requirement. This interaction gives rise to the possibility of dual action and the risk that the authorities will take inconsistent or uncoordinated actions to respond to the same breach. Dual action may lead to contradictions—for example, where a supervisor

restricts distributions (which impacts the institution's debt market access) while the resolution authority requires the issuance of additional subordinated debt. In addition, the current situation where no particular sequence or hierarchy is established between the various measures available does not reflect the logic of a progressive gradation or escalation in response to a breach.

It is therefore important to consider the scenarios in which an institution might breach its MREL, the interaction of that scenario with minimum capital requirements, and the appropriate lead authority in each case. In broad terms, an institution may breach its MREL either by failing to roll over or issue sufficient MREL-eligible debt or because losses have degraded its capital position to the extent that it has used up its CBR CET1 and some of its regulatory capital and it was also counting those regulatory capital instruments towards its MREL requirement.

(i) Breach of MREL – Losses impacting minimum capital requirements

Where an institution suffers losses, these will impact its capital position. If it has any CET1 in its CBR, this will be depleted first (triggering the application of the MDA restriction regime). If the losses are of a sufficient magnitude, other capital instruments will then be depleted, including potentially capital instruments on which the institution is relying to meet its minimum capital requirements. At this stage, the institution would be in breach of its CBR and its minimum capital requirements. If the institution was also relying on those capital instruments for the purposes of meeting its MREL requirement (which is likely) and it has no other MREL-eligible instruments to replace them, it would also be in breach of its MREL requirement.

In this scenario—where an MREL breach coincides with a breach of the minimum capital requirements—the competent authority should be in the lead in terms to responding to the breach. The competent authority already has substantial powers to address breaches of capital requirements. However, because the breach of capital requirements coincides with a breach of MREL, the competent authority should consult the resolution authority on the use of these powers. The timeline for a consultation response in these circumstances should be appropriately short (e.g. 72 hours) to ensure that the reaction of the competent authority to the capital requirements breach is not delayed by the need to consult the resolution authority. In all circumstances, the competent authority and resolution authority should strive to coordinate their actions and cooperate in relation to the response.

(ii) Breach of MREL – Failure to roll over MREL-eligible debt

An MREL breach may also arise from the failure of an institution to roll over MREL-eligible debt or to issue MREL-eligible debt in the first instance.

In these circumstances, it is appropriate for the resolution authority to take the lead role in remedying the breach, particularly given the powers they have (and which are proposed for them in this report) in relation to the maturity and issuance of an institution's liabilities and other measures to address impediments to resolvability as already foreseen in the legal framework. Given the impact of any actions proposed by

the resolution authority on the institution's liability structure, it is important that the competent authority has the ability to comment on the proposed response. Therefore, before using its powers to respond to the breach, the resolution authority should be required to consult the competent authority. The timeline for a consultation response in these circumstances should also be appropriately short (e.g. 72 hours) to ensure that the reaction of the resolution authority to the MREL breach is not delayed by the need to consult the competent authority.

This consultation is particularly important if the stacking order approach is adopted, since the institution's CBR will also have been depleted by the breach (as CET1 will have been reallocated to MREL). In all circumstances, the competent authority and resolution authority should strive to coordinate their actions and cooperate in relation to the response.

(iii) Breach of MREL – Losses and failure to roll over MREL-eligible debt

It is possible that a breach of MREL may occur simultaneously with a breach of capital requirements, where an institution suffers losses that deplete its capital and fails to roll over MREL-eligible debt that results in a (more serious) breach of its MREL requirement. In these circumstances, it is arguable that the institution is failing or likely to fail, and that the relevant assessment should therefore be performed. However, if the authorities agree that the institution is not failing or likely to fail in this situation, it is appropriate that a plan be put in place for both its capital and MREL to be restored. Therefore, the power to agree on a joint restoration plan should be provided to the authorities. Such a plan should aim to address the need of both restoring the institution's capital and restoring the institution's stock of MREL-eligible debt at the same time. It should be agreed jointly between the authorities.

The plan should be provided by the institution to the competent authority and resolution authority, which should consult one another and attempt to reach an agreement on the adequacy of the plan. If both authorities consider the plan to be inadequate, they should each be able to adopt other measures necessary to restore compliance with the requirements for which they are responsible. Again, any actions taken should be coordinated (through formal consultation requirements) to the greatest extent possible.

Finally, a number of fundamental principles should guide the responses of the authorities in relation to an MREL breach.

Proactive monitoring is crucial: At all times—and as occurs at present—the competent authority should monitor the capital position of the institution. Similarly—and as set out in Section 5.4 (on maturity) and Section 9 (on reporting and disclosure) of this report—the resolution authority should be required to closely monitor the institution's MREL position. The respective authorities should inform each other of breaches or risks of breaches in the near future, or failure or risk of failure to roll over MREL-eligible liabilities. They should also consult each other on the remedial measures engaged.

Ultimate responsibility for enforcing own requirements: In each case, actions taken by one authority to address a breach of a requirement for which they are responsible would be without prejudice to the powers of the other authority to take action where deemed necessary. Ultimately, authorities should be able to pursue enforcement action in their own remit to recognise respective responsibilities and avoid forbearance. In all instances where the authorities are using powers to respond to a breach, the resolution authorities and competent authorities should duly consult each other and coordinate their actions.

Close cooperation and coordination of responses: While resolution authorities and competent authorities should have ultimate responsibility for their respective requirements, inconsistent and uncoordinated action should be avoided to the greatest extent possible. Therefore, at a minimum, consultation on the use of powers (within appropriate time frames) is necessary. Ideally, actions taken would be agreed upon by both authorities.

Proportionate response: The response to a given breach, and actions taken, should be proportionate, while nevertheless recognising that MREL is a minimum requirement that should be met at all times.

Final recommendations

The EBA recommends that resolution authorities and competent authorities should engage in active monitoring of compliance with their respective requirements.

The powers of resolution authorities to respond to an MREL breach should be enhanced. In particular, resolution authorities should be given the power to: (i) require the preparation and execution of an MREL restoration plan; (ii) utilise powers to remove impediments to resolvability relating to MREL compliance on an expedited basis; (iii) request that distribution restrictions be imposed on the institution by the competent authority; and (iv) request a joint restoration plan in cases where an institution breaches both MREL and minimum capital requirements.

The response to a given breach should depend on the source of that breach, with the lead authority clearly specified and the other authority in a consultation role. The competent authority should be in the lead role in responding to losses that result in a breach of minimum capital requirements as well as MREL. The resolution authority should be in the lead role in responding to a failure to issue or roll over MREL-eligible debt leading to a breach of MREL (and possibly the CBR if the stacking order approach is adopted). If there are both losses and a failure to roll over or issue, both authorities should attempt to agree on a joint restoration plan (provided both authorities consider that the institution is not failing or likely to fail).

At all stages, there should be close cooperation and coordination between the authorities. Finally, the actions taken by the authorities should be proportionate to the nature and extent of the breach in question.

The above-mentioned approach could be laid down in Level 1 legislation and/or further specified via RTS or Guidelines.

5.4 Redemption and maturity management of MREL-eligible funds

In order for bail-in to be a credible resolution tool that can pass losses to shareholders and creditors of a distressed institution, it is essential that sufficient financial instruments subject to bail-in are available at the point that the institution enters into resolution. The MREL and TLAC standards were introduced to facilitate this goal, as both impose a regulatory requirement on institutions to issue sufficient financial instruments subject to bail-in that support the resolution strategy envisaged for the institution.

Crucial to the functioning of the MREL and TLAC standards is the requirement that liabilities issued to meet the requirement have a sufficient maturity. If instruments with short maturities were capable of being used by institutions to meet their MREL or TLAC requirements, they would likely be redeemed or have expired before they could be used to absorb losses in a resolution of the institution. Therefore, both MREL and TLAC require that, in order to be eligible under the respective standards, instruments must have a remaining maturity of at least 1 year. It is important that resolution authorities monitor the stock and maturity of eligible liabilities available to each institution to meet their MREL requirement on an ongoing basis. In addition, resolution authorities should have the power to address potential issues regarding the maturity profile of an institution's MREL-eligible liabilities on a proactive basis. There should also be an approval regime with respect to situations where an institution wishes to redeem MREL-eligible liabilities but doing so would bring it into non-compliance with its MREL requirement, or where it is already failing to meet its MREL requirement.

5.4.1 Maturity management and monitoring

The existence of a hard legislative maturity threshold of 'at least 1 year' creates the risk of a 'cliff effect'. Where an institution is unable to roll over or reissue maturing MREL-eligible debt, it may come into sudden non-compliance with its MREL requirement. An inability to issue or roll over eligible instruments may be related to the idiosyncratic position of the institution itself, but it may also be related to a general downturn in the market.

In order to enhance the role of MREL as a minimum regulatory requirement and to avoid a sudden unanticipated breach, resolution authorities should be required to monitor the maturity profile of each institution's MREL-eligible instruments. If resolution authorities are required to monitor the maturity profile of eligible liabilities, it is important that they have adequate information gathering powers. Where a resolution authority identifies an issue with the maturity profile of an institution that represents an impediment to that institution's resolvability, it should have the power to require the institution to alter the maturity profile of its MREL-eligible instruments—including by issuing new instruments—in order to remedy the deficiency. This would be consistent with the TLAC term sheet that provides (in Point 9) that '*the appropriate authority should ensure that the maturity profile of a G-SIB's TLAC is adequate to ensure that its TLAC position can be maintained should the G-SIB's access to capital markets be temporarily impaired*'.

Requirement to monitor maturity profile

At present, there is no obligation on resolution authorities to monitor the maturity profile of MREL-eligible liabilities. The BRRD does require Member States to ensure that institutions meet their MREL requirements at all times, but this does not explicitly require the monitoring of MREL compliance or, indeed, likely future compliance through maturity profile monitoring. In order to reinforce the importance of MREL as a minimum regulatory standard and to ensure—to the extent possible—that unanticipated breaches of this requirement cannot occur, it may therefore be appropriate to impose a specific obligation on resolution authorities to engage in proactive monitoring of the maturity profile of the MREL-eligible liabilities of institutions for which they have set an MREL requirement. This will ensure that institutions' MREL positions can be maintained should their access to markets be temporarily impaired.

If resolution authorities are required to monitor the maturity profile of eligible liabilities in this manner, it is important that they have appropriate powers to do so. A number of provisions of the BRRD address the gathering of information by resolution authorities, but no provision neatly provides resolution authorities with the power to monitor the maturity profile of an institution's MREL instruments. Information gathering powers for resolution authorities are currently provided in the following contexts:

- In order to draw up and update a resolution plan;
- Where the lack of the provision of information constitutes an impediment to the resolvability of the institution in question;
- In order to undertake a valuation for the purposes of resolution;
- In order to support a resolution action;
- In order to ensure that there is an appropriate information exchange between an institution under resolution and a recipient of a financial instrument, right, asset or liability;
- In relation to a competent authority where necessary to exercise the resolution authority's tasks under the BRRD;
- In order to investigate possible breaches of requirements for the purpose of taking administrative sanction actions.

Of the above powers, only three appear to be of potential use for a resolution authority that needs to monitor the maturity profile of an institution's MREL-eligible liabilities and none are fully suited to that purpose.

The power to gather information for drawing up and updating a resolution plan could be used to monitor the maturity profile of an institution's eligible liabilities and, indeed, Section B of the Annex of the BRRD provides that resolution authorities may request the '*details of those liabilities of the institution that are eligible liabilities*'. Nevertheless, monitoring the maturity profile of an institution's MREL stack in the context of the resolution planning process is suboptimal for a number of reasons. The resolution planning process is designed to take place, in general, over the course of a year (although higher and lower frequencies are also envisaged). Even undertaking a resolution planning process on a relatively higher frequency (e.g. quarterly) for an institution may

not be sufficiently frequent to monitor and respond to the evolving liability profile of the bank. Furthermore, the resolution planning process involves an assessment that goes far beyond just the maturity profile of the institution's MREL-eligible instruments. Using these powers to obtain a snapshot of the maturity profile of an institution's liabilities would entail using expansive powers to obtain relatively targeted information.

The resolution authority can also impose on an institution '*specific or regular additional information requirements relevant for resolution purposes*' as part of its impediment removal powers. A lack of reliable, up-to-date information regarding the maturity profile of an institution's MREL-eligible liabilities may indeed constitute an impediment to its resolvability. However, as set out in Section 5.3 above, the use of these powers takes some time and allows an institution the opportunity to propose alternative measures to achieve the same outcome. The powers are also institution-specific, requiring a new assessment for each institution from which data is desired. Where specific information is sought in relation to the discrete issue of the maturity profile of an individual institution's MREL-eligible liabilities, resolution authorities need an alternative and more targeted power that applies to all institutions and is quick to deploy.

Finally, subject to the provisions of confidentiality, resolution authorities and competent authorities are required to provide each other, on request, with all information relevant for the exercise of their respective tasks under the BRRD. Therefore, to the extent that competent authorities collect information that would enable a resolution authority to monitor the maturity profile of an institution's MREL-eligible liabilities, the resolution authority could get access to that information. While it may be desirable to align reporting requirements in this way in order to avoid duplicate data requests, this option is also suboptimal. It requires the resolution authority to rely on data collected by the competent authority, most likely in a different context and for a different purpose. The competent authority may not collect sufficiently granular data relating to the specific matters that the resolution authority needs to know, leading to an information gap. It is desirable, therefore, for the resolution authority to have a specific and targeted power for the purpose of collecting this data.

In light of the foregoing, resolution authorities should be required to monitor the stock and maturity of each institution's MREL-eligible liabilities and they should have an appropriate power in order to do so. The power could be also provided with regard to any power given in the context of MREL reporting (as set out in Section 9 below). Finally, the resolution authority should be required to share the information gathered with the competent authority; this is particularly important in a context where the stacking order approach is adopted and the failure to roll over MREL-eligible debt could result in a breach by the institution of its CBR and the (eventual) triggering of MDA restrictions.

Power to alter the maturity profile

Concomitant with a requirement for resolution authorities to monitor the maturity profile of each institution's MREL-eligible liabilities, resolution authorities should also have the power to direct an institution to alter this maturity profile where the current profile is deemed likely to represent an impediment to the resolvability of the institution. In fact, the TLAC term sheet provides (in Point 9) that '*the appropriate authority should ensure that the maturity profile of a G-SIB's TLAC is adequate to ensure that its TLAC position can be maintained should the G-SIB's access to capital*

markets be temporarily impaired'. Such an alteration power could include the power to require an institution to issue liabilities with a certain maturity; or to attempt to renegotiate any outstanding eligible liabilities.

Powers such as the ones proposed in this report already exist in the BRRD, in the context of the removal of impediments. At present, as part of an impediments removal process, resolution authorities have the power to require an institution to issue eligible liabilities to meet its MREL requirement or to take other steps for the same purpose, including (in particular) attempts to renegotiate an MREL-eligible liability the institution has issued with a view to ensuring that a decision to write-down or convert that liability would be given effect under the law of the jurisdiction governing the liability or instrument. Nevertheless, these powers are not suited to the purpose for a number of reasons; therefore, refinements are required.

In the first instance, regarding resolution authorities' general impediments removal powers, a relatively long and cumbersome process must be undertaken before these powers can be used. In circumstances where the existing maturity profile of an institution makes it likely that the institution will breach its MREL requirement in the near future, a resolution authority may need to act expeditiously to pre-empt and prevent such a breach.

In addition, the existing powers target MREL compliance in general, rather than allowing more specific maturity monitoring and alteration that aim to prevent a breach in the first place. Requiring an institution to issue MREL-eligible liabilities to meet its MREL requirement does not mean that a resolution authority can specify the maturity of such new liabilities beyond the existing MREL requirement of having an outstanding maturity of '*at least 1 year*'. This inability to specify the maturity of any newly issued instruments may again result in a cliff effect (i.e. all newly issued instruments mature at the same time in the future) and insufficient certainty around future compliance with the requirement (i.e. newly issued instruments have a maturity only slightly above 1 year). Similarly, the ability to require an institution to attempt to renegotiate existing eligible liabilities focuses on the enforceability of write-down provisions (and thus is related to Article 55 of the BRRD) rather than more general renegotiation (such as on extensions of maturity). While the BRRD text in this area is drafted relatively broadly and potentially could be used for the purposes outlined above, greater clarity on this point would be appropriate.

Any use of a power to alter the maturity profile of an institution as described above will have an important impact on the supervision of the institution in question. While any extension of the maturity of the liabilities of institutions is unlikely to be a cause for supervisory concern, it is nevertheless important that the resolution authority maintains close contact and cooperation with the competent authority when exercising this power. Therefore, an explicit consultation requirement with the competent authority would be appropriate when proposing the use of this power.

Finally, given the relatively wide-ranging nature of the responsibilities and powers proposed and the potential degree of discretion available to resolution authorities in their use, it may be appropriate for further standards and guidance to be developed. This would avoid the risk of divergent practices within the EU and would help to preserve the level playing field. It could therefore be considered appropriate to provide the EBA with a mandate to develop technical

standards on the monitoring of maturity profiles of MREL-eligible instruments and on the use of powers to alter those maturity profiles.

5.4.2 Approval for redemptions

The CRR provides for a conditional regime for redeeming own funds, under which the competent authority shall only grant permission for an institution to reduce, repurchase, call or redeem own funds instruments if: (i) the institution replaces the instruments being redeemed with new instruments, or (ii) the institution has demonstrated that it has a sufficient margin above regulatory capital requirements.[123] Under Article 78(1)(b) of the CRR, the competent authority may consider that a margin is necessary on top of the minimum requirement for own funds. The competent authority can then refuse to allow redemptions if it believes that the institution does not have an appropriate margin over minimum requirements. This permission regime avoids any sudden breaches of capital requirements or undesirable deteriorations in capital levels above the requirement as a result of a redemption. It also prevents institutions from inappropriately redeeming instruments in a manner that brings them, or would be likely to bring them, into breach of their minimum capital requirements.

Point 12 of the TLAC term sheet provides that approval for redemptions is required for external TLAC in cases where a breach of the minimum requirement would occur if the redemption occurred. No margin is provided for with respect to the approval regime set out in the TLAC term sheet. It should also be noted that the TLAC term sheet and the BRRD provide that, if the holder of the instrument has redemption rights, then the instrument is not eligible for TLAC/MREL unless the redemption right can be exercised (at the earliest) within 1 year. The maturity of the instrument will be the earliest day when the redemption right arises.

To the extent that MREL is met with own funds instruments, the competent authority would also exercise this approvals competence with regard to MREL. However, the resolution authority does not play any role in this process at present. In addition, the conditions for granting or refusing permission to redeem are not linked to MREL eligibility (the institution could replace MREL-eligible own funds with non-MREL-eligible own funds) or with the required level of MREL. However, a competent authority or resolution authority cannot prevent the redemption of MREL-eligible instruments that are not part of own funds. In other words, the current CRR regime is neither meant nor fit for purpose in the resolution area.

Redemption approvals for MREL-eligible instruments

At a minimum, the approach to redemption approvals set out in the TLAC term sheet should be adopted in the EU. However, given that the issue addressed by a redemption approval regime is the same regardless of the type of bank concerned, this regime should be extended to all banks and not just to G-SIBs.

Consideration could also be given to adopting an MREL redemption approval regime similar to the capital redemption approval regime, by introducing the concept of a margin within which the resolution authority would be entitled to refuse redemption even if the redemption would not

[123] Article 78(1) of the CRR.

bring the institution into breach of its minimum requirements. However, there are important differences between the capital framework and the MREL framework that justify adopting the narrower, TLAC term sheet approval regime. In the first instance, a significant number of instruments may theoretically qualify for MREL or TLAC, and therefore a more expansive approval regime would potentially be very burdensome for the authorities and institutions themselves. In addition, this report recommends substantial other powers for resolution authorities with respect to the maturity profile of institutions' MREL. To the extent that these recommendations are adopted, resolution authorities would have sufficient powers to appropriately manage the MREL profiles of institutions without also requiring an expansive redemption approval regime. Careful consideration also needs to be given to the interaction between the existing capital redemption approval regime and the proposed MREL redemption approval regime.

Therefore, in order to implement the TLAC term sheet requirement, it is proposed that a redemption approval regime also be introduced for MREL-eligible instruments. In order for such a regime to operate effectively, it is crucial that institutions are obliged to inform the resolution authority whenever they intend to redeem MREL-eligible instruments, where they know or reasonably believe that such a redemption would bring them into breach of their MREL requirement (or the CBR if the stacking order approach is adopted). This requirement should also apply where an institution proposes to undertake a redemption when it is already in breach of its MREL requirement.

In addition to this notification requirement for institutions, there should be a requirement for explicit approval from the authorities where the redemption of the instrument would lead the institution to breach its MREL requirement (or, if the stacking order approach is adopted, its CBR due to the reallocation of CET1) or where it is already in breach of its MREL requirement.

In terms of the appropriate authority to provide approval, this would depend on the nature of the instrument in question:

- If an institution proposes to redeem a capital instrument that it is using to meet its MREL requirement, the existing capital approval regime should continue to apply (i.e. the competent authority would be informed and would ultimately be responsible for deciding whether to grant the approval or not). However, as an alteration to the existing regime, the institution should notify the competent authority and resolution authority if it knows or reasonably believes that the redemption will bring it into breach of its MREL requirement (or the CBR if the stacking order approach is adopted) or if it is already in breach of its MREL requirement. In these circumstances, the competent authority should be required to consult the resolution authority before deciding on whether or not to grant the approval. There should be a clear time frame for the resolution authority to respond, in order to avoid inappropriately delaying the process.

- Where the institution proposes to redeem a non-capital instrument that it counts towards MREL and it knows or reasonably believes that the redemption will bring it into breach of its MREL requirement (or the CBR if the stacking order approach is adopted), or it is already in breach of its MREL requirement, it should be required to notify the resolution authority. The resolution authority would be required to assess the proposed redemption and to approve or

reject it. The resolution authority could take into account the resolution strategy (single point of entry (SPE) or multiple point of entry (MPE)), group-level issues, and entity-level and resolution entity-level issues. Finally, in exercising this redemption approval power, the resolution authority should be required to consult the competent authority (with an appropriate time frame for a response), as the proposed redemption may be taking place in a wider context of supervisory engagement with the institution (e.g. as a recovery measure).

Final recommendations

The EBA recommends that the legislative framework should contain a requirement for resolution authorities to monitor the maturity profile of the MREL-eligible instruments of each institution for which an MREL requirement has been set. Proactive monitoring of the maturity profile of the MREL stack should ensure that institutions' MREL positions are maintained should access to markets be temporarily impaired. This would ensure consistency with the TLAC standard.

Resolution authorities should be provided with explicit power to gather the necessary information on a regular basis in order to facilitate this monitoring. This power should be exercised in coordination with the competent authority (to avoid duplicating monitoring requirements), as the competent authority also has an interest in monitoring the maturity profile of MREL given its potential impact on the CBR under the stacking order approach.

In order to ensure the harmonisation of the data collected within the EU, the EBA could be empowered to draft ITS establishing the data to be collected from institutions as part of this monitoring exercise. This could be linked to any general mandate to develop ITS on MREL reporting requirements, such as that proposed in this report. The EBA could be further mandated to adopt technical standards to foster the harmonisation of the application of the requirement and power.

The EBA further recommends that the legislative framework should contain a power for the resolution authority to request an institution to modify the maturity profile of its MREL stack. Such a power should be available where the resolution authority is of the view that the maturity profile of the institution's existing MREL-eligible instruments constitutes an impediment to the resolvability of the institution. The use of the power could follow a more expedited process than the existing impediment removal process set out in the BRRD. When exercising this power, the resolution authority should be required to consult with the competent authority.

In addition, the EBA recommends that a redemption approval regime should be introduced for MREL-eligible instruments. Where the institution knows, or reasonably believes, that a proposed redemption would lead to a breach of its MREL requirement or where it is already in breach of its MREL requirement, it should be required to notify the resolution authority of this before undertaking the redemption. If the instrument it proposes to redeem is a capital instrument, it should also be required to notify the competent authority that the redemption may lead to a breach of its MREL requirement or that it is already in breach of its MREL requirement. For capital instruments, the ultimate approval would continue to rest with the competent authority under the existing capital redemption approval regime, although the competent authority would be

required to consult the resolution authority where there might also be a breach of MREL or where there was an existing breach of MREL. For non-capital instruments that are being counted towards MREL, the resolution authority would ultimately be responsible for approving the redemption. Nevertheless, the resolution authority should consult the competent authority within a defined time frame in these circumstances. In the absence of approval, the institution should not be entitled to redeem the instrument.

5.5 Treatment of MREL cross-holdings

In order to reduce the risk of contagion, Recommendation 15 of the TLAC term sheet provides that '*G-SIBs must deduct from their own TLAC or regulatory capital exposures to eligible external TLAC instruments and liabilities issued by other G-SIBs*'. The rationale is similar to that for deductions in the field of capital: to avoid the build-up of artificial capacity that would vanish upon failure and cause contagion via cross-default.

The TLAC term sheet entrusts the BCBS with further specifying this recommendation and with recommending the treatment for non-G-SIBs. The BCBS published its final position in October 2016.[124] In the FSB's view, G-SIBs and non-G-SIBs should deduct all TLAC holdings that qualify as capital from their own regulatory capital and deduct other TLAC holdings from their Tier 2 regulatory capital.

The current EU framework already provides some mitigation against the build-up of MREL cross-holdings:

- The CRR[125] lays down a deduction regime for exposures of institutions to other institutions' capital instruments. It is not within the mandate of this report to deal with those exposures, which will remain governed by the existing (like-for-like) capital deductions regime;

- The CRR[126] provides for a large exposure regime that limits the exposure of an institution to any other institution;

- The need to avoid contagion via cross-holdings is also reflected in the criteria for setting MREL, as provided for in Article 45 of the BRRD. Thus, in setting the level of MREL for an institution, resolution authorities are required to take into account the need to ensure that, if the resolution plan anticipates that certain classes of eligible liabilities might be excluded from bail-in, the institution has sufficient other eligible instruments.[127] They must also take into account the extent to which the failure of the institution would have adverse effects on financial stability, including through contagion to other institutions due to its interconnectedness with these institutions or with the rest of the financial system.[128]

[124] http://www.bis.org/bcbs/publ/d387.pdf.

[125] Article 452 and following of the CRR.

[126] Part Four of the CRR, Articles 387 to 403.

[127] Article 45(6)(c) of the BRRD.

[128] Article 45(6)(f) of the BRRD.

This sections aims to identify solutions to implement the TLAC recommendation in a manner that is appropriately integrated with the EU framework.

(1) Instruments issued by G-SIBs and held by G-SIBs and non-G-SIBs:

Under the BCBS recommendation, subordinated instruments eligible for TLAC and issued by a G-SIB should be deducted from an investing bank's Tier 2.

When adopted in the FSB context, this approach was justified for two reasons:

- First, in the international context, not all banks are subject to TLAC; therefore, a corresponding approach whereby TLAC exposures would be deducted from the own TLAC of the investing institution is not available. Instead, a deduction from Tier 2, a universal requirement as per the Basel framework, is felt to appropriately disincentivise TLAC cross-holdings;

- Second, deduction from Tier 2 ensures that a bank can absorb losses on TLAC cross-holdings through going concern capital instead of gone concern loss-absorbing capacity, thereby reducing the probability of failure.

However an alternative approach could be considered in the context of the EU for the following reasons:

- First, EU G-SIBs may be subject to MREL requirements exceeding the TLAC floor. It remains to be determined how to treat cross-holdings of MREL instruments beyond TLAC, with the risk of a dual regime that would be hard to justify;

- In addition, deduction from Tier 2 is an expensive option for institutions, given that it implies deduction of instruments ranking above Tier 2 from a Tier 2 base that is more expensive to issue. Such an approach may be justified at an international level where only G-SIBs are subject to the TLAC requirement, in the EU, non-G-SIBs are also required to respect an MREL requirement largely pursuing the same objectives as TLAC. This creates a commonality across the sector and therefore reduces the justification of a deduction from Tier 2;

- Finally, depending on the treatment that will be decided in relation to the holdings of the MREL instruments of non-G-SIBs, deduction from Tier 2 could create a different regime for G-SIBs and non-G-SIBs.

In order to address these EU-specific issues, an extended approach is proposed, whereby G-SIBs and non-G-SIBs should deduct MREL holdings of other G-SIBs from their own MREL on a like-for-like basis. This approach would reflect the existence of MREL as a cross-cutting requirement in the EU and could be less costly while continuing to discourage cross-holdings (albeit to a lesser extent than the BCBS approach).

De minimis threshold

Under the current Basel III framework, if the investing bank does not own more than 10% of the common shares of the issuer, then capital holdings are deducted only to the extent that they exceed a tolerance threshold. Amounts below the threshold are risk weighted instead. The threshold is set at 10% of the investing bank's common equity.

In relation to TLAC, the BCBS has recommended a double threshold:

- The existing 10% tolerance threshold applicable to capital would be extended to TLAC-eligible holdings. This means that TLAC holdings may be included within the 10% tolerance threshold that previously only applied to regulatory capital holdings;

- The BCBS has also introduced an additional tolerance threshold that may be only used for non-regulatory capital TLAC holdings. This threshold is set at 5% of the investing bank's common equity, with holdings being measured on a gross long basis. As for the 10% tolerance threshold, this threshold only applies where the investing bank does not own more than 10% of the common shares of the issuer.

This approach, which is meant to preserve market-making activity, is also justified in relation to MREL holdings and it is therefore proposed to integrate it into the corresponding approach described above.

(2) Deduction of MREL instruments issued by non-G-SIBs

The contagion risk inherent in cross-holdings of MREL instruments is also valid in relation to banks' holdings of instruments issued by non-G-SIBs. On this basis, on the one hand, it may be envisaged to apply the same approach to deductions for MREL holdings issued by non-G-SIBs as would be applied to holdings of instruments issued by G-SIBs.

On the other hand, the treatment of exposures to non-G-SIBs should also be assessed against the more limited funding sources available to those institutions. Additionally, it might in practice be difficult for an investing bank to identify which senior instruments issued by a smaller bank are eligible for MREL from the point of view of the issuing bank, as the resolution authority might have applied a partial subordination requirement on a case-by-case basis only. In comparison, for TLAC instruments issued by a G-SIB, it will be much clearer what instruments are eligible for TLAC for the issuing institution.

At this stage, as shown in Table 23, if a deduction approach were applied in relation to instruments issued by non-G-SIBs, it would have a minor effect on subordinated eligible liabilities of banks that are neither G-SIBs nor O-SIIs, but would have a non-negligible effect on O-SIIs. In any event, this analysis is made in the present context and the situation could evolve with the introduction of MREL as banks seek purchasers of MREL debt within the sector itself.

Table 23: Cross-holdings of MREL debt instruments

	G-SIBs		O-SIIs		Others		Total
	(bn EUR)	as % of MREL	(bn EUR)	as % of MREL	(bn EUR)	as % of MREL	
Total MREL instruments	**1761.9**		**1649.1**		**409.2**		**3820.2**
Cross-holding of non-capital MREL-eligible liabilities	263.4	14.9%	191.2	11.6%	23.9	5.8%	478.5
of which senior eligible	*149.1*	*8.5%*	*122.2*	*7.4%*	*23.6*	*5.8%*	*294.9*
of which subordinated eligible liabilities	*114.3*	*6.5%*	*69*	*4.2%*	*0.3*	*0.1%*	*183.6*

Source: EBA QIS data (December 2015)

Therefore, as an alternative option for the MREL issuances of non-G-SIBs, a specific dedicated large exposure framework could be implemented in relation to holdings of non-G-SIBs' non-regulatory capital MREL instruments.

Concretely, G-SIBs and non-G-SIBs would see their exposure to MREL-eligible instruments of any individual non-G-SIB limited to a given threshold representing a sub-limit within the current 25% large exposure limits[129] set out in Article 395 of the CRR. Given that one of the objectives underpinning this option is simplification, holdings of senior instruments issued by non-G-SIBs would be fully included in the limit, rather than on the proportionate basis described in the following paragraphs.

On the one hand, this solution—explored previously by the BCBS in relation to senior holdings of TLAC—would limit contagion within the banking sector, reduce complexity and limit the potential inability of non-G-SIBs to access markets for MREL-eligible liabilities. On the other hand, it would create a different treatment from the one envisaged for holdings of instruments issued by G-SIBs.

In any event, the calibration of the threshold should be determined on the basis of an impact assessment, also taking into account that the reference base in the current large exposure regime[130] is being reviewed in the context of the implementation in the CRR of the 2014 Basel large exposures standard.

(3) Treatment of senior cross-holdings of MREL instruments

An issue arising is how to treat senior liabilities, considering that—depending on the scope of subordination requirements—some senior liabilities may be eligible for MREL and others not.

[129] Article 395(1) of the CRR: 'An institution shall not incur an exposure … to a client or group of connected clients the value of which exceeds 25 % of its eligible capital…'.

[130] The reference base for large exposure limits is currently linked to the bank's Tier 1 and Tier 2 capital. However, this may change in the future as a result of the review of the CRR. Therefore, the reference base for the ad hoc large exposure limit might be the investing bank's Tier 1 capital.

The BCBS has analysed this issue and had originally contemplated the full deduction of senior exposures with an original maturity of over 1 year.[131] However, after consultation, a proportionate deduction regime was eventually preferred over a full deduction approach or a non-deduction approach. Under the final BCBS standards, holdings of TLAC-eligible instruments that rank senior should be deducted from the TLAC of the investing bank only to the extent that they qualify as TLAC (proportionate deduction).

In this context, it is suggested that G-SIBs and non-G-SIBs should deduct their holdings of senior instruments from their senior MREL base to the extent that those instruments are MREL-eligible from the perspective of the issuing bank. This approach would require periodic disclosure with respect to the issuer containing sufficient information to enable the investing bank to calculate the proportion of any funding class being recognised as MREL-eligible. Such disclosure would also be facilitated by clear legislative provisions on the scope of automatic subordination requirements as per Section 6.1.

Final recommendations

The EBA recommends that exposures to MREL-eligible instruments issued by all credit institutions should be deducted from MREL on a like-for-like basis[132] above a double threshold meant to preserve a share of market-making activity. Holdings of senior instruments should only be deducted to the extent that they are eligible for MREL (the proportionate deduction approach), unless the large exposure limit approach set out below is adopted for issuances of non-G-SIBs.

While this solution departs from the Tier 2 base recommended by the BCBS, the EBA considers this departure justified in the EU context where all banks are subject to an MREL requirement. Alternatively, deduction from the Tier 2 base could be retained with a view to full compliance with the BCBS recommendation.

In addition, if a deduction regime was considered as hindering the development of the market for MREL instruments issued by non-G-SIBs, an ad hoc large exposure sub-limit should be introduced for holdings of MREL-eligible instruments issued by those banks within the large exposure limits set out in Article 395 of the CRR. The calibration of the sub-limits should rely on an impact analysis, taking into account the effect on non-G-SIBs, consistency with the deduction approach and consistency with the overall large exposure framework. These elements could be analysed in the context of an EBA report and eventually set out via RTS. Given that one of the objectives underpinning this option is simplification, holdings of senior instruments issued by non-G-SIBs would be fully included in the limit, rather than on the proportionate basis described above.

[131] BCBS Consultative Document, TLAC holdings, November 2015.

[132] As explained above, the treatment of holdings of MREL-eligible instruments that also qualify as capital instruments is beyond the scope of this report and will remain governed by the CRD/CRR.

5.6 Relationship between MREL and the NSFR

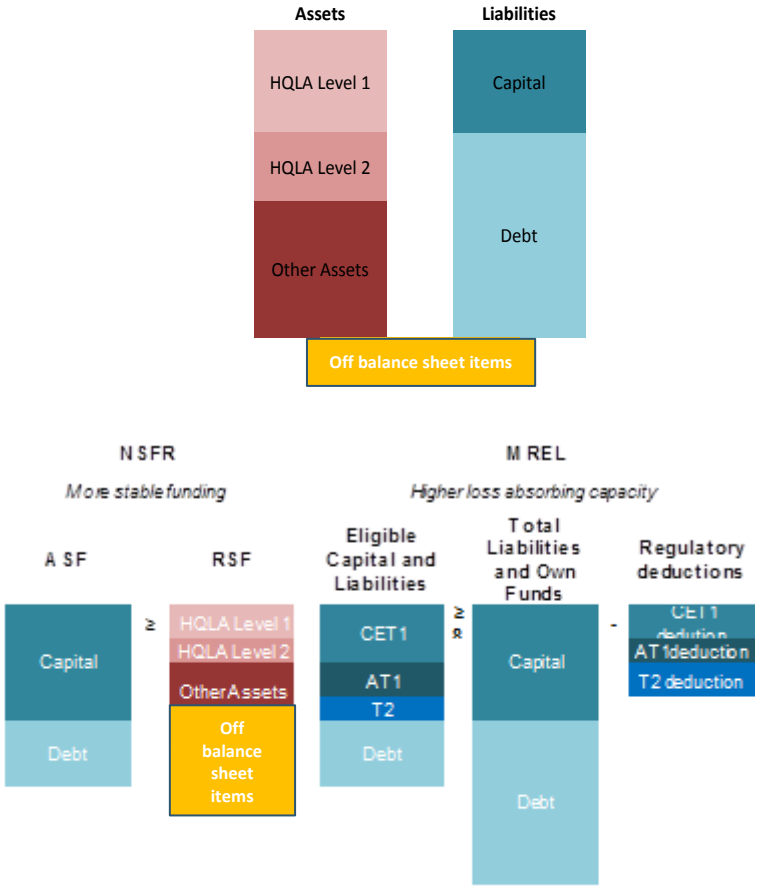
Composition

The NSFR requires firms to match long-term, illiquid assets with long-term stable funding:

- Assets are weighted based on their liquidity to calculate a firm's required stable funding (RSF), and its liabilities are weighted based on their stability to calculate its available stable funding (ASF);
- A firm's NSFR is equal to ASF/RSF. This should be 100% or more.

The MREL ratio shares similarities with the NSFR numerator. Similar to the NSFR, MREL includes capital and debt in its calculation (see Figure 29 below).

Figure 29: Components of MREL and the NSFR



However, the scope of the eligible liabilities to be included in the calculation is stricter for MREL than for the NSFR:

- The ASF includes some liabilities with a residual maturity below 1 year and some secured funding, while these types of liabilities are explicitly excluded from the MREL numerator. Instruments with a maturity of below 1 year are subject to varying weightings within the NSFR calculation depending on the type of instrument and the respective maturity. The MREL framework does not include any liabilities with a maturity less than 1 year and, in this regard, treats these liabilities equally;

- In addition, term deposits are considered key components of the ASF while they are not included in MREL if covered by the DGS.

Interaction

MREL and the NSFR are complementary—both encourage firms to use more long-term funding. Liabilities eligible for MREL (equity and debt with > 1 year maturity) all receive a 100% weight under the NSFR.

- In normal times – MREL and the NSFR are mutually reinforcing and banks can also issue liabilities that aid in meeting both the NSFR and MREL/TLAC. However, it should be noted that it is possible for a bank to improve its NSFR while not improving its MREL ratio by increasing the instruments that are non-eligible under MREL but are considered as stable funding (e.g. covered term deposits and/or by substituting illiquid assets with liquid assets);

- In times of financial stress – Having MREL liabilities helps to maintain the NSFR in times of financial stress. Nevertheless, there are no explicit consequences mentioned in Basel III on what a breach of the NSFR implies;

- Once bail-in is implemented – The liabilities that were converted into equity still help to meet the NSFR. As equity also receives a 100% weighting, converting long-term debt to equity in bail-in would not, in itself, affect a firm's NSFR. Bailing-in short-term liabilities might improve the NSFR although any write-down (to absorb losses) would negatively affect the NSFR.

Both MREL and the NSFR are expected to be met on an ongoing basis (as per Recommendation 11 of the EBA report on the NSFR).[133]

Following a resolution, there may need to be a period of flexibility in how the NSFR is enforced in order to allow the bank to restore its market access and liquidity position and to rebuild MREL, while, at the same time, ensuring that the conditions for authorisation and market confidence in the firms are maintained.

Final recommendations

The EBA's view is that interactions between MREL and the NSFR do not give rise to any need for policy change.

[133] Available at: https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-22+NSFR+Report.pdf.

6. Eligibility criteria for MREL

6.1 Subordination and compliance with the NCWO safeguard

One of the elements to take into account when revising the MREL framework with a view to implementing the TLAC standard is the requirement that TLAC instruments should be subordinated to operational liabilities. This section discusses the rationale for subordination (Section 6.1.1), the various approaches currently available (Section 6.1.2) and possible options for introducing a subordination requirement in the EU for G-SIBs and beyond (Section 6.1.3).

6.1.1 Rationale for subordination – Ensuring continuity in critical functions and avoiding risks regarding a breach of the NCWO principle

To make resolution credible, the legal and operational structure of a bank or a banking group must continue to support critical functions and critical shared services under the preferred resolution strategy. This objective could be significantly hindered if certain operational liabilities are affected by the resolution action.

In order to avoid this consequence and ensure the continuity of critical functions, Article 44(2) and (3) of the BRRD provide for exclusions to bail-in.

Nevertheless, these exclusions are not a panacea for at least two reasons:

- First, it is essential that there remain sufficient financial instruments subject to bail-in available to ensure the funding of resolution, and this is why resolution authorities are required when determining MREL to factor in any anticipated exclusion from bail-in of certain otherwise eligible liabilities.[134]

- Second, where bail-in exclusions are applied to certain operational liabilities essential to the continuity of critical functions, those liabilities that are not excluded from bail-in and that rank pari passu with the excluded liabilities are at risk of breaching the NCWO principle. The BRRD and SRMR require that creditors are not treated less favourably in resolution than they would have been in insolvency. They provide creditors with a right to compensation, paid from the resolution fund, if they are treated less favourably. Given the NCWO principle, which derives from the fundamental right to property, if the authorities fully write-down senior bondholders in bank resolution while excluding certain operational liabilities with which they rank pari passu in insolvency due to exclusions set out in Article 44(2) and 44(3) of the BRRD, bondholders may assert that they would have received better treatment in liquidation. In order to avoid this outcome, Article 44(4) of the BRRD provides the possibility for the resolution fund to make a contribution to the institution under resolution in lieu of the losses that should have been borne by creditors who have been excluded from bail-in. However, such a contribution is possible only if the shareholders and creditors of the institution have

[134] Article 45(6)(b) of the BRRD.

made a contribution to loss absorbency and recapitalisation of 8% of the institution's TLOF. Depending on the funding structure of the bank, this may not be possible without operational liabilities bearing losses, or may not be possible at all if the bank is predominantly funded by liabilities excluded from bail-in (e.g. secured liabilities or covered deposits). Resolution authorities therefore need to consider the risk of breaching the NCWO safeguard in their resolution planning and MREL decisions. Under Article 3(3) of the RTS on MREL, resolution authorities are required to assess the risk of a breach of NCWO when the resolution plan envisages that a significant part (> 10%) of any insolvency class of creditors would be excluded from bail-in (or loss absorbency under another resolution strategy).

One way to reduce the risk of a breach of the NCWO principle is to ensure that the creditor hierarchy in insolvency is aligned with the likely treatment of creditors in resolution. Concretely, if the liabilities that can most credibly contribute to loss absorbency (senior unsecured debt) are subordinated to operational liabilities, then the risk of such a breach is likely to be significantly reduced because they would also have borne losses first in liquidation.

Subordination has other benefits. The possibility to write-down or convert non-operational liabilities first, without having to consider exclusions, may increase resolution authorities' speed of action at the resolution stage, especially in the early stages of the development of resolution plans. In addition, subordination can increase market transparency and help to ensure that certain debt instruments are perceived and accordingly priced as clearly most loss-absorbing by investors. This is likely to increase market discipline and incentivise better risk diversification. Clarity over loss absorption should also reduce the risk of market-wide pricing shocks when a resolution actually occurs. Finally, senior liabilities (such as unsecured deposits) are typically prone to risks of run in case of financial distress, while these risks are less acute if a cushion of subordinated debt absorbs losses first.

6.1.2 Current approaches to subordination – TLAC, BRRD and national approaches

TLAC term sheet

In response to the risks described above, a subordination requirement has been included in the TLAC standard for all G-SIBs.

The TLAC standard requires that resources eligible for TLAC be subordinated to liabilities that are specifically excluded from TLAC, such as sight deposits or liabilities arising from derivatives.[135]

The TLAC standard provides for two exemptions to this requirement:

- Subordination is not required where the amount of excluded liabilities ranking alongside the TLAC-eligible instruments concerned does not exceed a de minimis amount of 5% of eligible TLAC resources;

[135] Recommendation 11 of the TLAC term sheet.

- In jurisdictions where the resolution authority may (under exceptional circumstances) exclude from bail-in the liabilities in Section 10 of the term sheet, the resolution authority may opt to allow resources (the equivalent of up to 3.5% of RWAs (2.5% of RWAs before 2022)) that rank alongside those excluded liabilities to count towards TLAC.

These exemptions may only be used where those resources that are made exempt from the subordination requirement would otherwise be eligible for TLAC, and would absorb losses prior to excluded liabilities in resolution without giving rise to a material risk of a successful legal challenge or valid compensation claims. Authorities must ensure that this is transparent to creditors.

These exemptions are mutually exclusive—i.e. only one may apply to an institution at any one time. If an institution meets the de minimis condition, all of its non-excluded liabilities may qualify for TLAC without being subordinated. If it does not, only a limited portion (2.5% of RWAs, rising to 3.5% of RWAs from 2022 onwards) of its non-excluded liabilities may qualify.

The BRRD framework

In contrast to the TLAC standard, pursuant to the BRRD framework, resolution authorities are empowered to decide on a case-by-case basis—within the context of their powers to address or remove impediments to resolvability—whether MREL-eligible debt should be subordinated or not and how this should occur.

Indeed, subordination requirements may not be necessary for all firms or resolution strategies. For example, where there is a credible, feasible resolution strategy that exposes all holders of senior liabilities equally to loss (including non-preferred deposits), there should be no need for any subordination beyond the BRRD prohibition for MREL to include liabilities arising from deposits that benefit from depositor preference.[136] An example of such a strategy is where the resolution authority plans to transfer only covered and otherwise preferred deposits, leaving behind senior liabilities in insolvency. MREL is still aimed at ensuring that the assets transferred exceed transferred liabilities, but, in this scenario, MREL-eligible instruments may not need to be further subordinated to other senior liabilities in order for the insolvency creditor hierarchy and resolution creditor hierarchies to be aligned.

Legal subordination methods and Member States' initiatives

Subordination may be implemented through three different legal methods:

- Statutory subordination, where MREL instruments rank junior to operational liabilities in the statutory creditor hierarchy;

- Contractual subordination, where MREL instruments are subordinated, as a result of their own contractual terms, to operational liabilities in the creditor hierarchy;

- Structural subordination, whereby MREL is issued by an entity (for example, a HoldCo) that does not have operational liabilities on its balance sheet that rank pari passu or junior to

[136] Article 45(4)(f) of the BRRD.

MREL-eligible instruments. Proceeds of those instruments are then downstreamed into a subsidiary as intragroup debt subordinated to operational liabilities in the subsidiary.

Several Member States have taken early policy initiatives on subordination to improve the resolvability of their banks and to assist in compliance with the FSB TLAC standard:

- **France**

The French approach consists of the creation of a new asset class, 'senior un-preferred debt', which French banks may issue to meet TLAC/MREL requirements. These securities will rank between subordinated debt and preferred senior unsecured debt and will need to have a maturity of more than 1 year. When issued, these senior un-preferred debt instruments will need to explicitly refer to their un-preferred ranking in their terms and conditions. The modification of the ranking of claims is not retroactive; the current stock of senior unsecured debt will not be affected by the changes and will carry 'preferred' status. The law[137] that includes the French approach to subordination was adopted in the French Parliament on 8 November 2016.

- **Germany**

Germany has changed the seniority of debt instruments in insolvency for CRR institutions. As of 1 January 2017, in insolvency as well as in resolution proceedings, shareholders will continue to absorb losses first, followed by existing subordinated creditors (including holders of regulatory capital instruments). However, within the class of ordinary creditors, holders of unsecured debt securities and other plain vanilla debt instruments will absorb losses before other ordinary creditors (such as derivative creditors). The new law[138] therefore creates a new subordinated subclass within the class of ordinary creditors. The law includes in this new subclass an exhaustive list of unsecured debt instruments (bearer bonds, registered bonds, and transferable loans) that must meet a number of criteria, and it will have a retroactive effect.

- **Greece**

Greece has changed the seniority of debt instruments in insolvency for CRR institutions.[139] This changed ranking in insolvency will also apply in resolution. In particular, according to the new law: a) all depositors now have a preferred status with three levels of seniority—covered deposits, eligible deposits of SMEs and physical persons above the coverage limit, and remaining deposits; and b) all senior unsecured debt is now subordinated to all other eligible liabilities.

[137] Projet de loi relatif à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique, cf. http://www.economie.gouv.fr/transparence-lutte-contre-corruption-modernisation.

[138] Sanierungs- und Abwicklungsgesetz vom 10. Dezember 2014 (BGBl. I S. 2091), das zuletzt durch Artikel 16 Absatz 9 des Gesetzes vom 30. Juni 2016 (BGBl. I S. 1514) geändert worden ist, BGBl. I S. 1864.

[139] Article 145(a) of Law 4261/2014.

- **Italy**

  The Italian law implementing the BRRD[140] extends depositor preference beyond the categories provided for under Article 108 of the BRRD, layering them though three levels of seniority: covered deposits, eligible deposits (the balance of deposits held by SMEs and natural persons above the EUR 100 000 limit) and all remaining deposits. In contrast to the German approach, uninsured deposits are preferred to senior bonds but senior debt ranks pari passu with other residual senior liabilities (e.g. contractual unsecured loans, derivatives (where these are not fully collateralised) and structured notes).

- **United Kingdom**

  For the purposes of enhancing resolvability, the United Kingdom requires major banks to issue new MREL-eligible senior unsecured debt from non-operating HoldCos, rather than from the operating legal entities that are CRR credit institutions.[141] This has the effect of ensuring 'structural subordination' of these liabilities. Indeed, their holders only have a direct claim on the value of the assets of the HoldCo, including its equity holding in the operating entity, which is therefore junior to the claim of direct creditors of the operating entity.

Much market commentary has focused on the difficulty for investors to understand the differences between these approaches and on the risk of fragmentation of the European market for bank senior debt as a result. The following considerations are arising:

- First, evidence based on market pricing is biased by other factors that might affect pricing, such as the relative size of TLAC issuance needs or the potential impact on funding costs of a retroactive subordination of the stock of senior debt combined with a prohibition to issue further senior debt. In principle, while subordination may be implemented through a number of different legal methods—statutory (e.g. Germany, Italy, France), contractual[142] or structural (e.g. United Kingdom)—as long as the choice of legal method does not affect the probability of default or loss given default, in principle, it should not affect the pricing of subordinated instruments. Early observations[143] suggest that the impact on pricing of the German bank subordination law is ambiguous and the United Kingdom transition from operating to HoldCo debt has so far provided a better proxy for pricing. However, further monitoring and analysis of market pricing will be needed before drawing any definitive conclusions.

- Second, differences in the resulting creditor hierarchy should, in principle, result in different loss given default expectations for otherwise similar instruments. It is too early to observe whether the impact of the German and Italian subordination laws will have significantly different impacts on pricing but, in principle, the lack of harmonisation of the creditor

[140] Law of 2 July 2015, and Legislative Decrees 180 and 181 of 16 November 2015.

[141] Structural subordination will be required for institutions subject to bail-in, with the exception of building societies (for which contractual subordination will be required instead).

[142] As an example, contractual subordination is legally possible in Spain but is not being used, and no explicit decision on subordination has been taken.

[143] See impact assessment section.

hierarchy is more likely to lead to fragmentation than the lack of harmonisation of the legal form of subordination.

- Finally, a lack of understanding may impose its own costs. Differences in legal method may increase the difficulty for investors to understand their position in the creditor hierarchy, potentially increasing risk premia and/or market segmentation. Following the implementation of the BRRD, rating agencies and investors have an increasing need to analyse the effects of national insolvency law on their loss given default expectations. This adds complexity and uncertainty, given the limited harmonisation of insolvency law within the EU, which could lead to the emergence of a price premium. Further work by national resolution authorities, the EBA or other European authorities to improve standardised information provided on creditors' positions in the insolvency hierarchy could help to mitigate this risk. A *'common approach to the bank creditor hierarchy'*, as called for by the Council on 17 June 2016,[144] could also bring about improved clarity in this regard.

The EBA is therefore of the view that a harmonised approach to the statutory subordination of MREL-eligible instruments would be desirable, without prejudice to the ability of authorities to continue to rely on other approaches to subordination.

6.1.3 Introducing a subordination requirement in the EU for G-SIBs and beyond

For G-SIBs

At a minimum, G-SIBs should be subject to a subordination requirement in line with the term sheet to the level of the TLAC floor.

By derogation, subordination would not be required provided that the conditions in the term sheet are met, particularly the condition that the exemption '*would not give rise to a material risk of a successful legal challenge or valid NCWO claims*'.

Two options are envisaged for taking decisions on whether that condition is met:

Option 1 – Case-by-case decisions: The resolution authority would determine, on a case-by-case basis, whether any exemptions from the subordination requirement should be allowed for a bank. Under this approach, subordination would be required for G-SIBs as per the TLAC term sheet, with an individual assessment carried out by the resolution authority as to whether the institution should be able to benefit from the term sheet exemptions from subordination or whether allowing this would give rise to a material risk of a successful legal challenge or valid NCWO claims. Such an approach, while potentially tailored to individual banks, could also potentially result in significant divergences across banks and an unlevel playing field.

Option 2 – Sensitivity threshold: Banks would only be able to make use of the subordination exemption if excluded liabilities are less than a certain percentage of a certain creditor class. The advantage of this approach is that it should promote consistency within the single market and a level playing field, as well as ensure the credibility and feasibility of the loss-absorbing capacity of

[144] http://www.consilium.europa.eu/en/meetings/ecofin/2016/06/st10324_en16_pdf/.

MREL liabilities, particularly of senior liabilities. The rationale for this approach is that where a large percentage of creditors from a particular class will be excluded from bail-in in resolution, the remaining pari passu liabilities should be subordinated to them to avoid the risk of NCWO claims from non-excluded liabilities. On the other hand, if relatively few creditors of a particular class will be excluded from bail-in, the remaining pari passu liabilities can remain pari passu to the excluded liabilities (thereby benefitting from the exemption from subordination), as the risk of NCWO claims is commensurately lower. This could be considered as a more stringent and harmonised version of the current rule in the RTS on MREL, whereby resolution authorities need to undertake an NCWO analysis if (mandatory and discretionary) exclusions within a creditor class exceed for example 10% of the class. In any event, it must be noted that a threshold does not provide certainty that the exclusion will not give rise to a material risk of successful legal challenge or valid compensation claims.

Beyond G-SIBs

As pointed out above, subordination facilitates resolvability and alleviates risks of NCWO compensation.

Admittedly, those risks are particularly acute for G-SIBs that are, by essence, resolved rather than liquidated. However, those risks are not confined to G-SIBs. This explains why, regardless of size, the RTS on MREL provides for a 10% sensitivity threshold beyond which the resolution authority must assess whether the additional burden can be borne by liabilities that qualify for inclusion in MREL without breaching the creditor safeguard.

Nevertheless, a fully case-by-case approach to subordination for all non-G-SIBs has its limitations:

- First, a case-by-case assessment is a difficult and possibly time-consuming exercise. The existing 10% sensitivity threshold is a very mechanical criterion. Once it is reached, there is little guidance offered to resolution authorities regarding the existence of NCWO risks. This could lead them to be reluctant to impose subordination or to overlook the potential risks. This complexity for authorities also impacts institutions and investors;

- Second, a different approach between G-SIBs and other banks might create an unlevel playing field, especially with the larger, internationally active, non-G-SIBs. It is difficult to justify banks with similar business models, liability structures and resolution strategies being subject to rules with very different cost implications.

Therefore, it might be preferable to legislatively provide for subordination in relation to a broader category of institutions than G-SIBs, to the extent that that category is defined with regard to:

- The risk of an unlevel playing field with G-SIBs;

- The likelihood that the banks covered would be subject to resolution rather than liquidation and especially subject to the bail-in tool;

- The cost of that option in terms of additional funding needs for the institutions concerned and, eventually, for the overall economy.

Having regard to these elements, O-SIIs are by definition systemic, and are generally more likely to be competing with G-SIBs. Therefore, an automatic subordination requirement should be extended to O-SIIs. However, any such automatic extension of the requirement should take into account the heterogeneity of the O-SII population in the EU. In particular, while an automatic subordination requirement appears to be justified for a majority of O-SIIs, there are some O-SIIs for which it may not be justified, having regard to their resolution strategy (e.g. those with a strategy involving liquidation, or those with a strategy involving the transfer only of preferred liabilities such as preferred deposits). The approach taken to subordination therefore needs to be appropriately nuanced to take account of these issues.

By contrast to O-SIIs, small to medium-sized banks are comparatively less likely to be subject to resolution. They are also more likely to face difficulties in accessing debt markets and would be expected to suffer a higher increase in funding costs as the result of any subordination requirement. Therefore, at this stage, it may not be advisable to suggest automatic subordination for all banks, but rather to rely on the current power to impose subordination on a case-by-case basis for banks that are neither G-SIBs nor O-SIIs.

In applying a legislative subordination requirement to O-SIIs, careful consideration should be given to the calibration and timing of any such requirement. In terms of calibration, considerations regarding a level playing field would support introducing a subordination requirement for O-SIIs that retains a link with the level required in relation to G-SIBs. On the other hand, G-SIBs are likely to have easier access to debt markets, especially on a cross-border basis, which is an element that could justify a 'premium' in comparison to O-SIIs. In addition, given the heterogeneity of the O-SII population, the resolution authority should have the power to adjust the calibration of the subordination requirement for an individual O-SII having regard to its resolution strategy.

In terms of timing, the final TLAC term sheet—containing detailed rules on calibration and subordination—has been public since November 2015; therefore, G-SIBs should have been drawing up issuance plans with its provisions in mind. In contrast, O-SIIs have not heretofore been made subject to any mandatory subordination requirement with respect to their MREL-eligible debt, and no MREL has been set for any entity in the EU. To the extent that a mandatory subordination requirement is introduced for the MREL instruments of O-SIIs, an appropriate transition period should also be established.

Based on these considerations, a subordination requirement of 13.5% of RWAs (+ CBR) could be applied to O-SIIs with an appropriate transition period. The resolution authority should have the power to adjust this calibration in exceptional cases having regard to the resolution strategy for the institution. The impact of this option has been quantified (see the quantitative section) and if this 13.5% subordination requirement was applied to all O-SIIs, it would result in a need to increase their stack of subordinated debt by EUR 44.4 billion, which would account for 1.1% of their RWAs.

Final recommendations

The EBA makes the following recommendations on the level and form of subordination required from banks.

With regard to the level of subordination:

- Under the revised framework, G-SIBs should be required to meet their MREL with subordinated instruments, at least to a level of 16% of RWAs in 2019 and 18% of RWAs in 2022 in line with the TLAC term sheet;

- The revised framework should also contain, mutatis mutandis, the grounds for exemptions to subordination provided in Recommendation 11 of the TLAC term sheet. Accordingly, subordination would not be required to the extent that the amount of excluded liabilities that rank pari passu or junior to MREL-eligible liabilities does not exceed 5% of MREL-eligible instruments. Alternatively, resolution authorities should be able to set a subordination requirement for G-SIBs not lower than 13.5% of RWAs in 2019 and 14.5% of RWAs in 2022. In both cases, the conditions of the term sheet should apply; in particular, the derogation should not give rise to a material risk of a successful legal challenge or valid NCWO claims. This risk assessment should either be made on a case-by-case basis or on the basis of a sensitivity threshold set by the BRRD;

- With regard to O-SIIs, the EBA believes that there is merit in introducing a subordination requirement at a level of 13.5% of RWAs with an appropriate transitional period. This subordination requirement would improve the resolvability of O-SIIs and alleviate NCWO concerns while preserving the level playing field. It would also contribute to the predictability of the EU resolution regime;

- The EBA recognises that the ability of banks to issue instruments at reasonable costs without undermining their medium-term viability depends on current market access and capacity, including access to deep, developed markets, and on the evolution of these conditions going forward. This evolution in capacity should be closely monitored. It cannot be adequately assessed at this stage, not least because a subordination requirement for O-SIIs would only be phased-in over several years;

- In addition, the EBA recognises the heterogeneity across O-SIIs in Europe and the possibility for differentiated resolution strategies. NCWO concerns would be particularly acute in a whole bank bail-in strategy, as compared, for example, to cases where the preferred strategy is liquidation or a partial transfer of preferred deposits;

- Therefore, alongside the 13.5% subordination requirement for O-SIIs, resolution authorities should be provided with a power to adjust that requirement for an O-SII on a case-by-case basis, taking into account the resolution strategy for the institution, the relevant debt market for that bank, and its liability structure;

- For any bank, it should be noted that the current BRRD framework already empowers resolution

authorities to require subordination on a case-by-case basis. This power should be maintained and exercised where subordination is not already required or not required to the same extent by the requirement described above.

With regard to the form, subordination should be met with instruments subject to structural, statutory or contractual subordination. The EBA does not recommend a particular form of subordination. However, the various national options for statutory subordination should be harmonised. A single statutory subordination option would improve investor clarity and facilitate resolution planning (including the identification of NCWO concerns) and resolution action, especially for cross-border groups.

6.2 Third-country recognition of resolution powers

When setting MREL, the resolution authority must consider the risk of liabilities being excluded from bail-in at the point of resolution and, if it anticipates that some liabilities might be excluded, ensure that the institution has sufficient other eligible liabilities to meet loss absorption and recapitalisation needs.[145]

In particular, exclusions could concern certain liabilities governed by third-country law for which it would not be possible to effect bail-in decisions and which, consequently—as referred to under Article 44(3)(a) of the BRRD—it would not be *'possible to bail-in … within a reasonable time notwithstanding the good faith efforts of the resolution authority'*.

The legislator has aimed to reduce the likelihood of such a situation by requiring credit institutions to include contractual recognition clauses in contracts governed by the law of a third country under the conditions of Article 55 of the BRRD. It has also provided the resolution authority with the power (under Article 45(5) of the BRRD) to require institutions, when setting MREL, to provide an independent legal opinion demonstrating that any decision of the resolution authority to write-down or convert that liability would be effective under the law of that third country.

However, to date, credit institutions have reported facing many practical difficulties in including contractual recognition clauses. For some categories of contract, such clauses would be operationally expensive to implement (e.g. utility contracts, small value contracts) or rejected by counterparties. For other contracts, such clauses would be impractical because they would require a change in broader market practices in the host country (e.g. contracts under standardised terms such as trade finance contracts) or are in conflict with local law or regulation (e.g. central counterparty (CCP) membership agreements). Resolution authorities' approach to addressing these practical difficulties may lead to inconsistent implementation of Article 55. For example, the United Kingdom PRA requires institutions to include contractual recognition language into non-EEA law governed contracts, but allows institutions to determine that the inclusion of the contractual term may be impracticable for certain liabilities. Impracticability

[145] Article 45(6)(c) of the BRRD.

could, for instance, cover certain trade finance instruments or liabilities to non-EU financial market infrastructures.[146]

Therefore, while this issue is not specific to MREL, the MREL framework would benefit from a clarification of the regime under Article 55, which could be achieved by narrowing the scope of the requirement while maintaining the effectiveness of contractual recognition for MREL liabilities. Several policy approaches could be adopted to narrow the scope of the requirement in Article 55 while maintaining the effectiveness of contractual recognition for MREL liabilities:

i. **Introduce additional exemptions,** particularly for CCP membership agreements, and defined categories of trade creditors;

ii. **Introduce a power for resolution authorities to grant waivers from Article 55**, where this would not create an impediment to resolvability. This could be limited to liabilities that are either a) not eligible for MREL or b) not eligible for bail-in. Alternatively, clarify that penalties should only be applied by resolution authorities when a failure to implement Article 55 constitutes an impediment to resolvability.

iii. **Limit the scope of Article 55**. Under this option, Article 55 would apply only to instruments that are eligible for MREL.

The first option outlined above presents the difficulty of having to outline, in advance, what categories of contract should benefit from such exemptions. A more discretionary regime would be appropriate, as there are circumstances in which it might not be feasible to include the clause for a particular type of contract. In addition, there may be a wider number of situations in which the need to waive the application of Article 55 arises.

Final recommendations

The EBA recommends that some reduction of the burden of compliance with third-country recognition requirements be introduced. This could be achieved by narrowing the scope of the requirement while maintaining the effectiveness of contractual recognition for MREL liabilities.

In order to do so, resolution authorities should be given the power to waive the application of Article 55 for certain instruments where it would be impractical for such a requirement to apply. Given the wide nature of such discretionary waivers, and in order to ensure harmonised application and a level playing field, the EBA could be mandated to further specify the circumstances in which it might be impractical to include such a term in an instrument in order to justify the granting of a waiver from the requirements of Article 55.

[146] http://www.bankofengland.co.uk/pra/Pages/publications/ps/2016/ps1716.aspx.

7. Calibration of the MREL requirement

This section discusses essential issues relating to the calibration of the MREL requirement. It explores the option of introducing minimum levels of MREL (floors) as part of the proposal on the harmonised application of MREL and the interaction of such floors with firm-specific MREL requirements (Section 7.1). Additional observations are made regarding the interaction of specific business models (Section 7.2), as well as the 8% bail-in rule (Section 7.3), with the calibration of MREL.

7.1 MREL floors and interaction with firm-specific requirements

The implementation of the TLAC term sheet, which suggests a hard floor for all G-SIBs, raises the issue of whether a minimum non-firm-specific requirement (or Pillar 1 MREL) should or could be introduced into the MREL framework and, if so, how it should interact with the current firm-specific requirement.

7.1.1 Calibration of MREL floors and resolution strategies

The determination of MREL is closely linked with resolution planning. The resolution authority needs to be sufficiently confident that loss absorbing and recapitalisation needs can be met at the point in time an institution is declared failing or likely to fail. Therefore, ultimately, MREL needs to be sufficient to enable resolution authorities to deliver their responsibility in order to ensure the resolvability of each bank.

Against that background, options for a minimum MREL requirement are illustrated in the context of four specific examples capturing the main possible configurations.

1) Case 1: A small bank with no critical functions, for which liquidation under normal insolvency would achieve the resolution objectives.

   In such a case, the base loss absorption amount calculated pursuant to the RTS on MREL will be equal to the supervisory capital requirements but may be adjusted upwards/downwards. No recapitalisation is anticipated.[147] As a result, the loss absorption amount (based on the minimum capital requirements) acts as an effective 'floor' for MREL for such banks and it would be difficult to define an alternative uniform floor above the capital requirements that would suit all such banks and situations.

2) Case 2: Less systemic bank, which would be partly resolved or sold with the residual part to be liquidated.

   In this case, it is assumed that only parts of the institution or certain functions are critical, and the resolution plan should determine the parts that are required to be continued. This is likely

[147] Article 2(2) of the RTS on MREL.

to mean that the institution's critical functions at least will be kept running (independently, or via sale to an interested purchaser), while other parts of the institution are liquidated.

Two options can be envisaged in terms of introducing an MREL floor in this type of situation:

Option 1 – No change. No MREL floor (or a floor equal to capital requirement). Recapitalisation amount as needed to recapitalise the parts resolved/sold set by case-by-case determination.

- Pros: Institutions will not be burdened with fulfilling MREL requirements that are, in the view of the resolution authority, not likely to be necessary. It is possible to adapt depending on the specificities of the bank—for example, the size or materiality of the critical parts that will be kept running, directly or indirectly via a sale.
- Cons: Risk of insufficient MREL if this separation of critical functions cannot be executed. This may require a wider bail-in, which could be detrimental for financial stability, particularly if DGS-eligible non-covered deposits need to bear losses or be converted into equity or the use of the resolution fund is required.

Option 2 – Floor including a recapitalisation part.

- Pros: Bail-in of non-MREL-eligible liabilities is less likely if the resolution plan needs to be changed to resolve a larger part of the bank than originally planned for.
- Cons: The individual situation of the institution is not taken into account and, thus, it may be excessively burdened with MREL requirements weighing on its profitability from a going concern perspective. It would be hard to find a floor that would suit all such banks and resolution scenarios.

3) Case 3: A systemically important bank that is not a G-SIB.

This is the case where the institution is systemic and complex, and it is assessed that it should be resolved as an open bank (i.e., resolution losses are to be recognised and absorbed and the bank recapitalised) to preserve financial stability, avoid market disruption and enable the bank to continue its provision of critical functions.

Again, in terms of introducing an MREL floor, two options can be envisaged:

Option 1 – No MREL floor (or a floor equal to capital requirement). The recapitalisation amount is based on a case-by-case assessment of whether the capital requirements have to be adjusted upwards/downwards depending on the resolvability assessment and the resolution planning process.

- Pros: Based on the case-by-case assessment, the institution will have sufficient MREL requirements to be fully recapitalised to the extent anticipated in the resolution plan, in case its losses are equal to or less than its capital requirements. MREL can be closely interlinked with resolution planning for each bank.
- Cons: If the institution faces a loss of sufficient magnitude that would result in the existing MREL amounts within the bank not being sufficient, a bail-in of instruments other than MREL-eligible instruments is likely to be required. The availability of such financial

instruments subject to bail-in outside MREL, as well as the credibility that they can be bailed-in in full or in part, can feed into the MREL determination.

Option 2 – Require an MREL floor for the loss absorption part with a recapitalisation part (e.g. with total calibration equal to the TLAC minimum requirement).

- Pros: All systemic institutions would be subject to the same minimum MREL floor, ensuring that each institution will have sufficient MREL to be fully recapitalised in case its losses are equal to or less than its capital requirements. The resolution authority can adjust the MREL upwards (but not downwards) based on their case-by-case assessment as in option 1.
- Cons: MREL is less interlinked with the resolution planning for each bank—for example, there would be no way to adjust MREL downward if there are a few non-material subsidiaries. This option may lead to an excessive burden for the individual institution, not justified by its recapitalisation needs in resolution. Additionally, this may be a risk, particularly for D-SIBs in smaller Member States, which are considerably smaller and less complex than the G-SIBs for which the TLAC standard has been developed.

4) Case 4 – G-SIB which would undergo an open-bank resolution.

This case is similar to case 3, option 2, with one difference: consistency with the TLAC term sheet implies that such an institution should be subject to the TLAC floor.

7.1.2 Interaction between MREL floor (Pillar 1) and firm-specific (Pillar 2) MREL requirement

Two lessons can be drawn from experience with Pillar 1 and Pillar 2 capital requirements under the CRR and the CRD. First, in order to ensure the consistent implementation of MREL and the development of a stable market for MREL instruments, it is essential to be clear about the stacking order and calibration methodology. Second, it is also essential to be clear about the other interactions between any common floor requirement for MREL and additional firm-specific MREL requirements.

The principles underlying the current assessment methodology set out in the RTS on MREL provide an appropriate basis for the calibration of firm-specific Pillar 2 requirements in addition to any Pillar 1 floor based on the resolution strategy. The RTS on MREL set out a methodology based on a two-part determination of a loss absorption amount and a RCA, with the possibility for adjustments to be applied to the total amount assessed as necessary. The loss absorption amount determination is largely driven by the capital requirements (both floor and firm-specific) applied by the relevant competent authority. The main choices for the resolution authority therefore relate to the determination of the RCA needed to implement the resolution strategy. This methodology has been elaborated based on extended discussion and consultation and, therefore, maintaining it would have the advantage of ensuring the stability of policy.

Applying the RTS on MREL methodology would lead to making an independent assessment of the firm-specific MREL requirement without reference to the floor requirement. The final MREL requirement would then be the higher of the amount determined by this assessment and the

MREL floor. See also the discussion below on options for the simplification of the RTS on MREL if changes are made to the Level 1 framework.

Such an approach would also ensure that a consistent methodology would be applied both to institutions subject to the MREL floor and to those outside its scope, avoiding the introduction of a 'cliff effect' in MREL requirements for institutions that fall just below the level of systemic importance required to be subject to the MREL floor.

7.2 Calibration of MREL for banks by business model

Resolution authorities are responsible for developing resolution plans and setting MREL at a level that enables the credible delivery of the resolution strategy. Therefore, the calibration of MREL must be closely linked to and justified by the resolution strategy, while business models should not mechanically predetermine a given MREL calibration that would be inconsistent with the resolution strategy.

This conclusion is consistent with the preliminary views expressed by resolution authorities in the qualitative survey of MREL: they show a preference for MREL calibration focused on resolution strategies and the systemic importance of institutions rather than business models per se.

Nevertheless, pursuant to the relevant RTS, resolution plans will have to contain a preferred resolution strategy *'capable of best achieving the resolution objectives given the structure and the business model of the institution or group'*.[148] Therefore, business models are worth considering when calibrating MREL, to the extent that they correspond to differences in resolution strategies and in the cost of complying with a given MREL requirement (most likely associated with particular funding structures). For example, in the United Kingdom's approach to setting MREL,[149] different calibrations are foreseen in relation to different resolution strategies, but those strategies are dictated by indicative thresholds not only in terms of size but also in terms of the number of transactional deposit accounts.

The results of the qualitative survey of resolution authorities (see Section 2) show particular concern with regard to the setting of MREL for small and medium-sized institutions that are predominantly funded through deposits. For these institutions, the current ratio of MREL-eligible liabilities (see Section 3.2) is, on average, slightly lower and, in some cases, their access to securities markets (domestically or on a cross-border basis) is perceived as limited (see findings 9 and 10 of qualitative survey results). There is some scepticism that deposits can be relied upon as a source of loss-absorbing capacity, first because the volumes of deposits not covered by a DGS guarantee or creditor preference are limited,[150] and, second, because of the risks of systemic contagion or bank runs in the case of losses to depositors.

[148] Commission Delegated Regulation of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the RTS specifying the content of recovery plans, resolution plans and group resolution plans, etc.. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016R1075.

[149] http://www.bankofengland.co.uk/pra/Pages/publications/081116.aspx.

[150] Deposits are eligible for MREL only if they have an outstanding maturity of more than a year, which excludes sight deposits and term deposits with outstanding maturity below 1 year. Additionally, since Article 12(1) excludes preferred

At the same time, a high degree of deposit funding—at least for institutions of a certain size—is a factor in determining systemic importance, since the protection of covered deposits is one of the main resolution objectives and a high share of covered deposits (everything else being equal) increases the likelihood of the public interest test being met in case of failure.

In this regard, a number of observations can be made.

First, the impact of MREL on predominantly deposit-funded institutions for which the strategy is liquidation will be very limited, as MREL will not be calibrated with a view to recapitalising any part of the business and will, in most cases, be equal to the own funds requirement.

Second, for some other predominantly deposit-funded institutions for which resolution would be the preferred strategy, if there are genuine difficulties in accessing debt markets, this may admittedly create obstacles to the build-up of MREL capacity. For those banks, various options could be considered by resolution authorities and policymakers. For example, a longer transitional period could be explored in order to phase-in MREL requirements in parallel with policy initiatives so as to improve access to debt markets (provided these are credible)—for example, in the context of the Capital Markets Union. Cross-border access to debt markets for small to medium-sized banks could thus be added as an indicator of the European Financial Stability and Integration Review.

Third, the potential contribution of DGSs is likely to play a greater role in the analysis with regard to deposit-intensive institutions insofar as the DGS would assume losses in lieu of covered depositors. The potential for a DGS contribution should be carefully assessed, taking into account the requirements under Article 109 of the BRRD, Article 10 of the DGSD, as well as the actual funding capacity of a DGS at a given point in time. A clarification of the current rules on DGS contributions would be useful, including the modalities and extent to which a DGS making payments in resolution is entitled to recoup its costs (as per Article 9(2) of the DGSD) without raising NCWO concerns for other creditors, and the modalities of funding recapitalisation given that the DGS cannot be required to make any contribution towards recapitalisation costs as per Article 109(1) of the BRRD.

Finally, the application of measures to remove impediments to liquidation, as well as resolution, may allow reduced MREL requirements for some such banks.

liabilities from the scope of MREL, covered deposits up to EUR 100 000, as well as deposits of SMEs and natural persons above EUR 100 000, are excluded. This leaves mainly interbank deposits above 1 year and deposits from large enterprises above 1 year.

Final recommendations

The EBA recommends that the calibration of MREL should, in all cases, be closely linked to and justified by the institution's resolution strategy. Business models may be worth considering when calibrating MREL to the extent that they translate into differences in resolution strategies.

The EBA further recommends that the current MREL assessment framework (under Article 45 of the BRRD and the RTS on MREL) be retained as the basis for setting Pillar 2/firm-specific MREL requirements. This means that MREL should be set as the higher of the requirement resulting from this firm-specific assessment and any Pillar 1 requirement, should one be introduced. Firm-specific requirements should be set only at levels necessary to implement the resolution strategy.

7.3 Requirement for accessing resolution funds

Resolution funds have been established in order to provide financing for resolution in the exceptional circumstances where a resolution scheme cannot be executed using only the financial resources of the failing institution (i.e. MREL and other financial instruments subject to bail-in in full or in parts) and the failure to execute the scheme would threaten financial stability or other resolution objectives.

Resolution funds can make a contribution to an institution under resolution only where, among other conditions, shareholders and creditors have made a contribution of at least 8% of TLOF[151] or 20% of RWAs[152] to loss absorption and recapitalisation (the 'threshold')[153].

The burden-sharing requirement that shareholders and creditors should make a contribution to loss absorption and recapitalisation of no less than 8% of TLOF or 20% of RWAs before the resolution fund may be used for certain purposes, as established by Article 44(5) of the BRRD, represents an important constraint on the actions of resolution authorities.

It is therefore necessary to take account of this constraint when assessing the criteria laid down in Article 45(6)(a) of the BRRD, which relates to the ability to apply the resolution tools '*in a way that meets the resolution objectives*' in the case of those systemically important institutions for whom Article 45(6)(f) of the BRRD is relevant.

However, the BRRD does not establish a mandatory relationship between MREL and the threshold. They are separate requirements with different purposes. The threshold will become relevant for the resolution of banks only if the resolution fund is to be used, while MREL should be determined on the basis of '*the need to ensure that the institution can be resolved by the application of the resolution tools, including, where appropriate, the bail-in tool, in a way that*

[151] Article 44(5) of the BRRD.

[152] Under the conditions of Article 44(8) of the BRRD.

[153] The same contribution to loss absorption and recapitalisation is also required as a condition, under Article 37(10)(a), for a resolution authority to seek funding from alternative financing sources through the use of government stabilisation tools.

meets the resolution objectives'.[154] Both mechanisms also have different scopes, as liabilities eligible for bail-in are more broadly defined than liabilities eligible for MREL.

A fair assessment of the criterion for setting MREL relating to '*the need to ensure that an institution can be resolved … in a way that meets the resolution objectives*'[155] will require the resolution authority to consider whether the institution's internal resources may not be sufficient and whether resolution financing arrangements might therefore need to be accessed. This assessment will be part of the determination of MREL but also, more generally, part of the development of the resolution plan, which must include an explanation of how the resolution options could be financed.[156] The protection of '*public funds, minimising reliance on extraordinary public financial support*' is one of the resolution objectives set out in Article 31(1)(c) of the BRRD.

In particular, the fact that an institution is of systemic significance and its disorderly failure would be likely to have adverse effects on financial stability will support the conclusion that the resolution fund might need to be accessed in order to resolve it. Article 45(6)(f) of the BRRD establishes such adverse effects on financial stability as one of the criteria on which resolution authorities have to base the determination of MREL.

In conclusion, the BRRD does not entail applying an 8%/20% threshold on an indiscriminate basis as a mandatory floor for MREL for all or a large set of banks. Instead, the MREL level is to be determined by resolution authorities on a case-by-case basis as it is closely interlinked with the resolution strategy for each bank. MREL should be set to what is assessed as needed to achieve the resolution objectives, and the final MREL set may be equal, above or below 8% of TLOF or 20% of RWAs, depending on the circumstances.

7.4 Options for simplification of the RTS on MREL if the Level 1 text is amended

Changes introduced to the Level 1 framework for MREL in the areas covered by this section may require consequential updates to the RTS on MREL.

Assumptions

This section is based on a number of assumptions that would need to be confirmed before any options for the simplification/clarification of the RTS on MREL can be finalised.

This section assumes that the current RTS on MREL framework remains fully applicable to banks that will face neither an MREL floor nor a mandatory subordination requirement. These will likely be medium-sized banks (non-G-SIBs and potentially non-D-SIBs). The RTS on MREL will need to be adapted for G-SIBs and potentially O-SIIs where an MREL floor and/or subordination requirement is applicable.

[154] Article 45(6)(a) of the BRRD.

[155] Ibid.

[156] Article 10(7)(i) of the BRRD.

It also assumes that double-counting of CET1 for both going concern buffer requirements and gone concern MREL requirements would be eliminated, as discussed in Section 5.1.

Introduction of a floor for some institutions

The introduction of a floor would impact Articles 1, 2 and 4 of the RTS on MREL:

- Article 1 – Determining the amount necessary to ensure loss absorption;
- Article 2 – Determination of the amount necessary to continue to comply with conditions for authorisation and to carry out activities and sustain market confidence in the institution;
- Article 4 – Business model, funding model and risk profile.

If an MREL floor were to be implemented in the BRRD, the RTS on MREL would need to refer to a floor equal to the higher of 16% of RWAs or 6% of the leverage ratio denominator as from 1 January 2019 and the higher of 18% of RWAs or 6.75% of the leverage ratio denominator as from 1 January 2022, for institutions within the scope of these requirements.

Article 1 could be amended such that resolution authorities will need to decide whether the going concern requirements (Pillar 1, Pillar 2 and buffers) are sufficient for loss absorption. If they are sufficient, then there should be no adjustment to the loss absorption amount of the floor or firm-specific requirements (this should be the default option). If not, then resolution authorities will need to adjust the loss absorption amount of the floor and firm-specific MREL upwards.

Article 4 could be amended to further specify whether the RCA should ensure compliance with only Pillar 1 capital requirements or potentially also Pillar 2 and buffers.

The BRRD and the RTS on MREL require resolution authorities to take into account the risk of exclusions from bail-in and the need for the resolution of the institution to be credible and feasible. The introduction of a subordination requirement for MREL would imply a need to revise Article 3 of the RTS on MREL (exclusions from bail-in or partial transfer that are an impediment to resolvability) and allow for the simplification of this article.

8. Intragroup issues

A mechanism for loss allocation within banking groups is crucial to facilitate resolution. The EBA report is required to assess three main areas in relation to intragroup issues: (i) whether the approach given in Article 45 of the BRRD to the application of MREL to groups is appropriate, and particularly whether the approach adequately ensures that the loss-absorbing capacity in the group is located in—or accessible to—entities that need it; (ii) whether the conditions for waivers from the minimum requirements are appropriate, and particularly whether such waivers should be available for subsidiaries on a cross-border basis; and (iii) whether the current EU requirements are consistent with the international standards developed by the FSB. At this stage, in the absence of any MREL decisions, it is not possible to conclude whether authorities have been faced with difficulties in applying the BRRD provisions on waivers or whether they have allowed authorities to strike the right balance between cost and absorbency.

After recalling the goal of an internal MREL framework, this chapter analyses the necessary elements to revise the BRRD in order to implement the FSB recommendation on iTLAC, as well as, more generally ensuring the appropriate allocation of internal MREL within EU groups.

8.1 MREL requirement below consolidated level

Internal loss-absorbing capacity aims to ensure that, within a group, losses are passed from the entities where they originate to those entities where resolution action is coordinated.

Resolution entities, to which resolution tools are expected to be applied, issue MREL-eligible liabilities to external parties (external MREL). All or part of the proceeds from this issuance is then downstreamed to subsidiaries, matched by equity or debt issued back to the resolution entity as 'internal' MREL resources.

These internal MREL resources provide a mechanism to pass losses from OpCos (where losses arise and which undertake critical functions) to the resolution entity to implement the resolution strategy. As a result, the resolution entity can (and should) be placed into resolution without significant disruption to the critical economic functions located in the subsidiaries.

This rationale underpins both the FSB TLAC term sheet and the BRRD.

- Recommendation 16 of the term sheet provides for an iTLAC requirement whose 'primary objective' is to '*facilitate co-operation between home and host authorities and the implementation of effective cross-border resolution strategies by ensuring the appropriate distribution of loss-absorbing and recapitalisation capacity within resolution groups outside of their resolution entity's home jurisdiction*';

- Equally, the BRRD recognises that '*it is imperative that loss-absorbing capacity is located in, or accessible to, the legal person within the group in which losses occur*'[157] (Recital 80). To that

[157] Recital 80 of the BRRD.

end, resolution authorities should ensure that the loss-absorbing capacity is distributed across the group (i) in accordance with the level of risk of its different entities; (ii) in accordance with the preferred resolution strategy; (iii) and keeping in mind that there could be circumstances where an approach different from that contained in the plan might be implemented. Resolution authorities can waive solo requirements under strict conditions and only where the parent and subsidiary are subject to authorisation and supervision by the same Member State.

8.2 Necessary amendments to the existing framework

As described, both the TLAC term sheet and the BRRD are underpinned by sound principles regarding the allocation of loss-absorbing capacity within a group in line with the resolution strategy. However, when it comes to concrete provisions to deliver this objective, the FSB TLAC term sheet is more precise and concrete than the BRRD:

- The term sheet requires resolution entities to be identified and requires that material subgroups meet an iTLAC requirement. The resolution entity acts as a source of loss-absorbing and recapitalisation capacity for its material subgroups. While external TLAC is issued at the level of the resolution entity, dependent entities issue iTLAC to which the resolution entity subscribes and leaves 'prepositioned' in the material subgroups in a range of 75% to 90% of the external minimum TLAC requirement, taking into account the size and risk exposures of its material subgroups. Eligible iTLAC instruments must be issued internally and subordinated to the subsidiary's operational liabilities in order to avoid a change in control of the subsidiary and limit risks of NCWO claims. Eligible iTLAC instruments must be subject to a power of write-down and/or conversion by the host resolution authority at the PONV of the subsidiary, without the entry of the subsidiary into formal resolution.

- In contrast, the BRRD does not contain a specific requirement for internally issued MREL and there is thus no distinction between the determination of internal and external MREL.

  In the BRRD, an MREL requirement must be set both at consolidated level and individual level regardless of materiality. The quantity of MREL of each entity is determined in accordance with the RTS on MREL and is therefore linked to the resolution strategy defined in the applicable resolution plan.[158] Where liquidation is the preferred strategy for an entity, resolution authorities can decide that institutions should hold an amount of MREL equal to the loss-absorbing amount in accordance with the RTS on MREL. Where the preferred strategy is resolution, the institution will be subject to an MREL requirement (including a RCA).

  MREL decisions, both at the consolidated and the individual subsidiary levels, are adopted via joint decision within resolution colleges. Any authority disagreeing with the joint decision may refer the matter to the EBA for binding mediation. However, with regard to MREL at the individual subsidiary level, the resolution authority of the parent entity can resort to EBA

[158] The applicable plan will be the group resolution plan, unless a host resolution entity has exercised its power to draw up its own resolution plan pursuant to Article 15(6) of the BRRD.

binding mediation only if the MREL set by the resolution authority of the subsidiary is 1% or higher than the amount set at the consolidated level.

These provisions do not set out in detail the consequence of resolution strategies in terms of identification of resolution entities, requirements for internal issuance, subordination requirements or the conversion trigger.

As a result, the BRRD provisions are underpinned by sound objectives but they are very broad and rely on implementation by—and agreement among—resolution authorities. They offer no visibility as to the correct form and calibration of internal MREL below consolidated level. This can lead to disagreement within colleges, and could make EBA mediation very difficult in a context where little guidance and no hard rules are available.

In addition, implementing the TLAC term sheet for G-SIBs without changing the overall framework for the broader population of banks could exacerbate the current shortcomings and create a discrepancy in approach between G-SIBs and other banks.

In this context, the EBA recommends that the current framework be refined in order to implement the FSB recommendation on iTLAC and, more generally, to secure alignment between internal MREL and the resolution strategy.

Under a revised framework, resolution authorities would identify resolution entities in the resolution plan, and require other entities to hold internal MREL as appropriate in relation to their treatment under the resolution strategy. Internal MREL should be subordinated to other liabilities to ensure upstreaming of losses and limit the risk of a change of control. An entity with an internal MREL requirement set in this way would not also have an external MREL requirement imposed on it. It would meet its MREL requirements through issuing internal MREL. PONV write-down of a subsidiary's MREL should be possible for all MREL-eligible instruments, and not just capital instruments. To that effect, Article 59 of the BRRD could be extended to all subordinated internal MREL instruments (rather than only capital instruments) to allow for the write-down of internal MREL at the PONV of the entity in question. This extension could also be achieved by requiring the introduction of contractual PONV write-down clauses within internal MREL instruments.

8.2.1 Scope of implementation of the FSB iTLAC recommendation

The TLAC term sheet recommends that material subgroups of G-SIBs be required to meet a minimum amount of internally issued TLAC in the range of 75% to 90% of the external minimum TLAC requirement that would apply to the material subgroup if it were a resolution group. An issue arising is how to interpret the concept of 'material subgroup', defined in the term sheet as one or more direct or indirect subsidiaries of a resolution entity '*incorporated in the same jurisdiction outside of their resolution entity's home jurisdiction*' (emphasis added).

In this regard, at a minimum, iTLAC should fully apply to material subgroups in the EU of third-country institutions. Material subgroups should be identified within European resolution colleges and would collectively need to meet the 75% to 90% calibration range, which would act as a collective floor. Individual entities would remain subject to MREL as per the BRRD.

With regard to subsidiaries of EU G-SIBs, there are elements to support the view that they do not fall within the ambit of the TLAC term sheet because the EU can be regarded as a single jurisdiction in which those entities are already subject to MREL. The term sheet was developed in an international context of sovereign authorities, where loss-absorbing capacity is not required across the board for all entities and where there are no dispute resolution mechanisms in case of disagreement. In that context, a minimum iTLAC requirement based on materiality criteria and quantitative thresholds makes sense. In contrast, within the EU, all institutions are subject to MREL and harmonised rules. MREL decisions are to be taken jointly within resolution colleges in full consistency with the resolution strategy and are subject, in case of disagreement, to EBA binding mediation. Therefore, it does not appear that the various national authorities within the EU should be considered as foreign jurisdictions under the term sheet and, on the contrary, the EU rules (especially if amended as described above) are likely to ensure a more prudent outcome in terms of the quantity of MREL required at the level of each entity. Notwithstanding this proposed treatment of the EU as a single jurisdiction in this regard, differences in national insolvency regimes in the EU should still be taken into account when assessing the NCWO implications of the internal allocation of MREL within a group.

8.2.2 Eligibility requirements for internal MREL

The eligibility requirements for internal MREL resources may need to be different from those for externally issued MREL, due to the different role it plays in a resolution. The three specific issues that should be considered are i) subordination to align the creditor hierarchies in insolvency and resolution, ii) intragroup guarantees, with appropriate safeguards, as an alternative to prepositioning for groups operating within the EU, and iii) the triggers for write-down or conversion.

8.2.3 Subordination of internal MREL

Absent a subordination requirement for internal MREL, an internal MREL instrument would absorb losses or be converted at the same time as other similarly ranked operational liabilities. This creates the risk of disrupting the critical economic functions provided by the subsidiary. In addition, the conversion of external instruments at the same time as internal MREL may affect the group structure, which may be problematic where an SPE strategy has been selected.

The need for the subordination of internal loss-absorbing resources is recognised in the TLAC term sheet. In contrast, the current criteria on MREL eligibility do not systematically require subordination. Pursuant to Article 45(13) of the BRRD, resolution authorities may require that part of the MREL requirement is satisfied with contractually subordinated liabilities. As a result, not all internally issued MREL instruments may be subordinated under the current regime.

8.2.4 Guarantees

The requirement to issue capital and debt instruments at subsidiary level, also known as prepositioning, is a reliable mechanism to support the implementation of the resolution strategy by absorbing losses and recapitalising an entity upon failure.

On the other hand, prepositioning constrains banks in centrally managing liquidity and financial resources at the group level, including in dealing with asymmetric shocks. The issuance at local level may also raise liquidity beyond the needs of the local operations from a business perspective, which could (in turn) lead to a search for more risky investment opportunities if no other way to reshuffle the liquidity within the group can be found.

A way to address this possible concern is to allow parental guarantees as an internal loss-absorbing instrument. While the notion may vary from one legal order to another, a guarantee is generally constituted by a commitment from a guarantor to pay a sum of money or to perform some duty or promise for another person in the event that that person fails to act. Guarantees can potentially provide loss-absorbing capacity in an intragroup context by ensuring that the obligations of a subsidiary are honoured by the parent in case the subsidiary fails to honour them. Guarantees may be appealing from the point of view of an institution as a way to avoid the risk of liquidity capture at subsidiary level (described above). Guarantees may, nevertheless, bear a cost depending on whether they are collateralised and to what extent.

Collateralised guarantees

The TLAC term sheet foresees that home and host authorities may jointly agree to substitute on-balance-sheet iTLAC with iTLAC in the form of collateralised guarantees,[159] subject to 6 conditions:

a) the guarantee is granted for at least the equivalent amount as the iTLAC for which it substitutes;

b) the collateral backing the guarantee is, following appropriately conservative haircuts, sufficient fully to cover the amount guaranteed;

c) the guarantee is drafted in such a way that it does not affect the subsidiaries' other capital instruments, such as minority interests, from absorbing losses as required by Basel III;

d) the collateral backing the guarantee is unencumbered and in particular is not used as collateral to back any other guarantee;

e) the collateral has an effective maturity that fulfils the same maturity condition as that for external TLAC; and

f) there should be no legal, regulatory or operational barriers to the transfer of the collateral from the resolution entity to the relevant material sub-group.

In the current BRRD framework, on the other hand, collateralised guarantees would not meet the MREL eligibility criteria specified in Article 45(4) of the BRRD—particularly condition (a), which requires MREL-eligible instruments to be issued and fully paid up. Guarantees would only play a role in two circumstances:

[159] Point 19 of the term sheet.

- First, the RTS on MREL acknowledges the possibility for resolution authorities to take into account capital resources available in other group entities when calibrating MREL requirements for individual entities or subgroups,[160] which could potentially allow for taking guarantees into account when determining the additional RCA under Article 2(7) of the RTS on MREL. However, it is worth noting that this provision only exists for the purposes of the market confidence component of the MREL requirement and that there is no explicit mechanism to adjust the MREL calibration to take account of guarantees;

- Second, guarantees may be concluded with a parent in order to obtain a waiver under Article 45(12)(e) of the BRRD, provided all the conditions for a waiver are met, particularly the condition that there is no current or foreseen material, practical or legal impediment to the prompt transfer of own funds or repayment of liabilities to the subsidiary by its parent.[161] However, no further guidance is provided on the conditions under which guarantees would meet those conditions. In addition, waivers are currently not possible where the parent and the subsidiary are not in the same Member State. Finally, Article 45(12) only refers to a full waiver, which means that guarantees could only be accepted in full replacement of prepositioned MREL and without the reassurance that the guarantee would be calibrated in a manner equivalent with the waived MREL requirement.

Admittedly, host Member States may be concerned that, if guarantees were accepted instead of prepositioned MREL instruments, the failure of a subsidiary may have fiscal consequences for them. Indeed, if there is no reassurance that losses will be upstreamed to the parent, then the subsidiary might have to be resolved or liquidated on a stand-alone basis. In that case, a lack of prepositioned MREL could cause a significant burden on the domestic resolution fund and the DGS.

Against this background, under a revised BRRD, resolution authorities could authorise a subsidiary to count collateralised guarantees provided by the parent towards meeting its individual MREL requirement under strict conditions in line with the TLAC term sheet. Guarantees should be collateralised and backed by liquid, low-risk assets, unencumbered by third-party rights. The decision to accept collateralised guarantees should be made jointly by resolution authorities in the context of the resolution planning exercise, on the basis of an explicit assessment that ensures that the type of guarantee proposed by the institution does not give rise to current or foreseen material, practical or legal impediments to the prompt transfer of own funds or repayment of liabilities to the subsidiary by its parent. In order to facilitate this assessment, the BRRD—with further specification in Level 2 measures[162]—should define sound criteria regarding the collateralisation of guarantees. Collateral should be marked to market and be sufficient (including a precautionary haircut) to cover the amount guaranteed. The institution requesting to use collateralised guarantees to meet its MREL requirement should also be required to produce a robust legal analysis to support the legal and operational enforceability of the instruments in all circumstances, including under the scenario where the resolution entity is itself in resolution.

[160] Article 2(10) of the RTS on MREL.

[161] Article 45(12)(d) of the BRRD.

[162] In the past, the EBA has provided extensive guidance on collateral arrangements for payment commitments to DGSs (EBA/GL/2015/09, 28 May 2015, Guidelines on payment commitments under Directive 2014/49/EU on deposit guarantee schemes).

Non-collateralised guarantees

Conceptually, non-collateralised guarantees could also constitute a form of loss-absorbing capacity, by creating a personal obligation of a parent to honour the liabilities of its subsidiaries to an amount and under conditions provided by the contract. Non-collateralised guarantees are naturally appealing cost-wise from the point of view of institutions as they avoid the immobilisation of assets as collateral.

On the other hand, in the absence of collateral to reassure authorities in the host Member State, further work is needed (for example, in an EBA report) to explore whether, and under which criteria, non-collateralised guarantees may actually constitute sufficiently robust loss-absorbing capacity, and thus potentially be eligible for MREL. Relevant considerations would include, *inter alia*:

- Whether a subsidiary can enforce such a non-collateralised guarantee at very short notice in a crisis situation, particularly on a cross-border basis and even where the parent refuses or is not in a position to honour its guarantee;

- Whether, where a parent is not in a financial position to be able to honour the guarantee, there is reassurance that the authority responsible for the parent would ensure that the parent is resolved in such a way as to preserve the subsidiary;

- Whether the non-collateralised guarantee of the parent is capable of being bailed-in in case of the resolution of the parent, and the effect on its loss absorbency and implications on NCWO concerns.

In this context, the establishment of the Banking Union could be seen as supportive of such instruments. Following the establishment of the Single Supervisory Mechanism, further strengthened by the Single Resolution Mechanism in 2015, group supervision has been significantly reinforced, especially for groups with entities located in Member States participating in the Banking Union. In the Banking Union, both competent and resolution authorities now have a clearer view of cross-border groups, as well as direct and enforceable powers directed at all group entities operating in different participating Member States. The establishment of a European deposit insurance scheme would alleviate concerns that the stand-alone liquidation of an entity would place a significant burden on the host DGS.

8.2.5 Triggers for write-down and conversion

Section 19 of the TLAC term sheet provides that iTLAC instruments must be subject to write-down and/or conversion by the host resolution authority at the PONV of the subsidiary, without the entry of the subsidiary into formal resolution. Write-down or conversion should be subject to the consent of the home authority. This is to ensure orderly resolution by applying resolution tools only to the resolution entity. If instruments are subscribed by the resolution entity and downstreamed as internal MREL, this provides a credible mechanism to pass losses to the resolution entity.

Such a statutory mechanism is not currently available under the existing EU legal framework. The powers in Article 59 of the BRRD allow the conversion or write-down, at the subsidiary level, of capital instruments that are recognised for the purposes of meeting own funds requirements on an individual and on a consolidated basis for entities that are deemed not to be viable, but without entering resolution and provided property rights are respected.[163] However, Article 59 of the BRRD does not apply to eligible liabilities that are not capital instruments, and it can be applied only if the issuing entity[164] is deemed non-viable.

Therefore, either a requirement to include contractual provisions allowing write-down or conversion of internal MREL instruments or an extension of the scope of the power in Article 59 to all internal MREL instruments should be considered.

8.2.6 Waivers in relation to credit institutions permanently affiliated to a central body

Articles 45(11) and 45(12) allow resolution authorities to fully waive, under strict conditions, MREL requirements at the individual level in relation to parents or subsidiaries for which the competent authority has fully waived the application of individual capital requirements in accordance with Article 7 of the CRR.

The rationale for including, as part of the conditions of an MREL waiver, the provision that capital requirements should have been waived pursuant to the CRR is that Article 7 of the CRR already entails conditions largely similar to Article 45 (11) and (12), including that there is no impediment to the prompt transfer of funds or repayment of liabilities by the parent undertaking.

As explained above, in the absence of MREL decisions, it generally appears premature to review the conditions on waivers. However, a possible inconsistency arises from the fact that no waiver is possible in relation to credit institutions permanently affiliated to a central body for which capital requirements have been waived pursuant to Article 10 of the CRR. The conditions for a waiver of capital requirements for credit institutions permanently affiliated to a central body largely support the passing of losses to the central body and also entail that the institutions and the central body are located in the same Member State.[165]

Therefore, it is recommended—as part of the upcoming legislative review—to assess whether Article 45(11) and (12) ensure neutrality across group structures or need to be extended to also cover institutions for which capital requirements have been waived pursuant to Article 10 of the CRR.

[163] According to the BRRD, the authorities have the power to convert/write-down AT1/T2 instruments issued at the level of subsidiaries without requiring that a resolution action is taken (Article 59(1) of the BRRD). Such write-down or conversion can be done if those instruments are recognised for the purposes of meeting own funds requirements on an individual and on a consolidated basis.

[164] Or, potentially, the consolidated group (in limited circumstances).

[165] The conditions for a waiver under Article 10 of the CRR include that (a) the commitments of the central body and affiliated institutions are joint and several liabilities or the commitments of its affiliated institutions are entirely guaranteed by the central body; (b) the solvency and liquidity of the central body and of all the affiliated institutions are monitored as a whole on the basis of consolidated accounts of these institutions; (c) the management of the central body is empowered to issue instructions to the management of the affiliated institutions.

Final recommendations

The EBA recommends that the MREL framework should be amended to provide for the identification of resolution entities and the allocation of internally issued, subordinated MREL at the non-resolution-entity level. In addition, the legislative framework should include a requirement to include contractual provisions allowing the write-down or conversion of internal MREL instruments, or alternatively an extension of the scope of Article 59 (PONV write-down) to all internal MREL instruments rather than only capital.

Under a revised intragroup framework, the EU should be treated as a single jurisdiction from the point of view of the iTLAC requirement. Consequently, the BRRD should implement a minimum internal requirement for material subgroups of foreign G-SIBs in the EU. In any event, EU subsidiaries of EU G-SIBs will be adequately covered by MREL.

Under a revised BRRD resolution, authorities should be able to authorise a subsidiary to count collateralised guarantees provided by the parent towards meeting its individual MREL requirement under strict conditions. Guarantees should be collateralised and backed by liquid low-risk assets, unencumbered by third parties. The decision to accept collateralised guarantees should be made jointly by resolution authorities in the context of the resolution planning exercise, on the basis of an explicit assessment that ensures that the type of guarantee proposed by the institutions does not give rise to current or foreseen material, practical or legal impediments to the prompt transfer of own funds or repayment of liabilities to the subsidiary by its parent. In order to facilitate this assessment, the BRRD (with further specification in RTS) should define sound criteria regarding the collateralisation of guarantees. Collateral should be marked to market and be sufficient to cover the amount guaranteed (including a precautionary haircut). The institution requesting to use collateralised guarantees to meet its MREL requirement may also be required to produce legal analysis to support the legal enforceability of the instruments.

Further work should be done (for example, in an EBA report) to explore whether, and under which criteria, non-collateralised guarantees could constitute viable loss-absorbing capacity, and thus potentially be introduced as an admissible form of MREL. In particular, the report would need to assess whether a subsidiary can enforce such an arrangement (and under what timeframe) in case the parent refuses to honour it, especially on a cross-border basis. The report would also reflect on the way in which to cater for situations where a parent would not be in a financial position to honour the guarantee, as there would be a need for reassurance that the authority responsible for the parent would ensure that the parent is resolved and the subsidiary preserved. A review clause should be introduced in the BRRD whereby, based on the conclusions of the report, the Commission could make appropriate proposals with a view to counting non-collateralised guarantees towards MREL.

Finally, it is recommended (as part of the upcoming legislative review) to assess whether the regime for waivers in Articles 45(11) and (12) ensures neutrality across group structures or needs to be extended to also cover institutions for which capital requirements have been waived pursuant to Article 10 of the CRR.

9. Reporting and disclosure

9.1 Reporting

Resolution authorities need access to granular, reliable, comparable, and high-quality data on capital and liabilities in order to determine the amount of MREL required from an institution, as well as to monitor whether the institution complies with an MREL decision. Information on liabilities is also needed for other purposes, such as resolution planning or even the application of the bail-in tool. Supervisors also have a keen interest in receiving MREL information, as MREL compliance is one of the indicators to be taken into account as part of the SREP and changes in MREL liabilities could have repercussions for the CBR if the stacking order approach is adopted.

However, unlike the CRD in relation to supervisory information, the BRRD does not contain any specific and explicit MREL reporting requirements. Currently, authorities collect MREL-related data via non-MREL-specific avenues,[166] such as data collection for the purpose of resolution planning. These efforts of resolution authorities in laying down early rules on data gathering for MREL and other purposes must be welcomed and developed.

However, they also raise a risk of inconsistencies in reporting form, content, format and burden across jurisdictions. In addition, as some data on capital and liabilities is already collected for supervisory purposes—as defined in Regulation 680/2014[167] (the FINREP and COREP templates)—there is a risk of overlap and a double burden for credit institutions.

With this in mind, it is necessary to develop (via ITS) uniform reporting templates applicable in all EU Member States. In order to avoid unnecessary work and duplication, those templates should take into account—and preserve as much as possible—the existing initiatives of resolution authorities in order to avoid duplication of work and unnecessary costs. In addition, in order to avoid a piecemeal approach to reporting for resolution purposes, the Level 1 text and the templates should also allow for the collection of data on liabilities for purposes other than MREL, such as resolution planning and bail-in execution.

Relationship with supervisory reporting requirements

Substantial experience has been gained, as well as infrastructures and processes developed, in the field of supervisory reporting. Consistency between the supervisory and resolution frameworks could be advantageous in several regards. First, to the extent reporting requirements—essentially assumed to be related to capital—overlap, they should be defined as much as possible in the same way, as this could to avoid an unnecessary burden for institutions. In addition, the technical

[166] For example, in February 2016, the SRB and the Banking Union's National Resolution Authorities (NRAs) designed and requested, for the first time, that the banks fill in (by 15 May or 15 June, on a best-efforts basis) an MREL reporting template—so-called the liability data template (LDT). LDT's objectives were to provide: i) an overview of institutions' liability structures; ii) information on the applicable capital requirements for determining MREL; and iii) detailed information on liabilities.

[167] Regulation 680/2014 defines reporting requirements for institutions with regard to own funds and own funds requirements, financial information and liquidity requirements (among others).

convergence of both templates could pave the way for joint collection by resolution authorities and competent authorities, which would optimise resources, minimise the burden for banks and facilitate the pooling of information of mutual interest by both authorities.

On the other hand, it must be recognised that, at the moment, institutions still report supervisory information to national competent authorities in different formats, and it is only when those competent authorities forward this information to the ECB or the EBA that the information is translated into an identical format. This translation can take a few days. If such a time lag was to be replicated in relation to MREL-related information, it may be acceptable within the context of a regular reporting exercise, but not for the purpose of an immediate collection prior to actual resolution action. In practice, this challenge will arise mainly in relation to the SRB, which will be the recipient of information related to institutions operating under several reporting formats.

Therefore, until solutions are found to address this technical challenge in all circumstances, it is proposed to provide an option for resolution authorities to also delegate to competent authorities the task of collecting information on MREL and other liabilities-related data for resolution purposes (in the context of the supervisory reporting exercise).

Final recommendations

The EBA recommends that the BRRD should provide for an explicit obligation for credit institutions to regularly report their level and composition of MREL instruments to resolution authorities. This information should be shared with competent authorities.

The EBA should be empowered to develop ITS laying down uniform rules and templates for the reporting of MREL-related data by credit institutions. The reporting ITS should also allow for the collection of other data on liabilities for resolution planning and bail-in execution, and should be based—to the largest extent possible—on existing frameworks developed by resolution authorities for the collection of MREL-related and other liabilities-related data. The ITS should define a reporting schedule, but the BRRD should explicitly allow the resolution authority to require an ad hoc collection at any time.

In addition, with a view to the possible integration of supervisory and resolution reporting processes, the Level 1 text and the ITS should allow (as an option) for the resolution authority to delegate the collection of data to the competent authority, which would then be shared with the resolution authority. To facilitate this process, the template should make use (whenever possible and appropriate) of the techniques and fields already used in the FINREP and COREP ITS (Reporting Regulation 680/2014).

9.2 Disclosure

There is currently no provision in the BRRD relating to the disclosure of MREL-related information to the public. Whereas competent authorities are empowered to request institutions to disclose information in relation to capital requirements, resolution authorities do not have this power in relation to MREL-related information.

Disclosing the MREL requirements and capacities of institutions would carry a number of benefits. It would provide transparency to investors and thus support market discipline, decrease speculations about banks' health and facilitate appropriate pricing. Contacts with investors and market analysts have confirmed the view that enhanced transparency about MREL is necessary for making informed investment decisions. In addition, a systematic disclosure requirement would facilitate the tasks of institutions in meeting current obligations under market transparency rules (these rules require disclosure whenever the information held may have an impact on pricing).

In this spirit, in its March 2016 consultation paper, the BCBS has proposed a regular disclosure of TLAC capacity, requirements, composition and creditor rankings for G-SIBS. The final position of the BCBS has not yet been communicated, but the BCBS templates could constitute a good basis for disclosure both in relation to G-SIBs but also non-G-SIBs.

This core information should nevertheless be complemented with additional information to allow investors to understand the probability of default and loss given default inherent in the instruments they buy. To this end, investors should be provided with information on the creditor hierarchy applicable to the instrument and the overall amount of financial instruments subject to bail-in.

9.2.1 Timing for the implementation of a disclosure requirement

MREL decisions have not yet been taken and while informal discussions are ongoing with banks, it would not offer firm ground to provide for transparency on indications given to banks in this context.

Once actual MREL decisions are taken, resolution authorities might (and are likely to) set a transitional period to reach the final MREL requirement as per Article 8 of the RTS on MREL. In that case, they must set a planned MREL for each 12-month period during the transitional period. The transitional period, starting from the time of the adoption of MREL decision until the expected build-up of the final MREL by an institution, is a crucial time because the institution will need to launch fresh issuances with a view to meeting its MREL requirement. In this context, disclosure could be required either in relation to the planned 12-month MREL decisions, or in relation to the final MREL decision, or both.

The assessment of a full disclosure requirement in the transitional period is ambiguous:

- On the one hand, it is necessary to establish a supportive investment environment in the upcoming years when most institutions will be in their transitional period. In order to buy into the issuance plan of an institution, investors would be assisted by knowing the path and the state of progress of the institution in relation to its MREL requirement;

- On the other hand, transparency in the transitional period raises challenges. It will expose differences among banks at a time when markets may not fully comprehend the new concepts underpinning MREL and resolution planning. It will also expose resolution authorities to the scrutiny of investors on their MREL decisions and resolution strategies, which might complicate their tasks in the initial years when resolution plans are progressively

refined. Finally, the disclosure of MREL requirements may put an upward pressure on prices as investors will know to which requirement each institution is subject.

As a result, and pending finalisation of the BCBS standard, it appears premature to introduce a full disclosure of MREL requirements in the transitional period. Instead, at a minimum, information on the stack of eligible liabilities and the creditor hierarchy should be provided to investors. In addition, disclosure should be required or actively encouraged if a failure to roll over MREL debt could lead to automatic restrictions on distributions as per Section 5.2.

Final recommendations

The EBA recommends that in the steady state, credit institutions in the EU should be required to disclose the quantum and composition of their MREL-eligible liabilities, as well as the MREL required from them by the resolution authority. The BCBS recommendations, once finalised, should serve as a starting point and should be extended to cover all of the MREL-eligible liabilities of G-SIBs and non-G-SIBs. They should also be extended to include information on other financial instruments subject to bail-in as well as information on the creditor hierarchy.

In the transitional period, and pending finalisation of the BCBS recommendation in this area, credit institutions in the EU should be required to disclose to investors the quantum and composition of their stack of MREL-eligible liabilities, as well as information on the creditor hierarchy (at a minimum). In addition, disclosure should be required or actively encouraged if a failure to roll over MREL debt could lead to automatic restrictions on distributions.

Annex 1: BRRD mandate for a report on MREL

Items to be covered by the EBA MREL report as per Articles 45(19) and (20) of the BRRD	
BRRD article	Item
Implementation of MREL, including transitional arrangements, identifying divergences in the levels set for comparable institutions and the use of contractual bail-in instruments	
45(19)(a)	How the minimum requirement for own funds and eligible liabilities has been implemented at national level, and in particular whether there have been divergences in the levels set for comparable institutions across Member States
45(19)(b)	How the power to require institutions to meet the minimum requirement through contractual bail-in instruments has been applied across Member States and whether there have been divergences in those approaches
45(20)(vi)	Prevalence of contractual bail-in instruments, and the nature and marketability of such instruments
Impact on different business models, including identification of these models, the impact of MREL on them, and a discussion of the appropriate MREL for each	
45(19)(c)	Identification of business models that reflect the overall risk profiles of the institution
45(19)(d)	Appropriate level of the minimum requirement for each of the business models identified
45(19)(e)	Whether a range for the level of the minimum requirement of each business model should be established
45(20)(a)(i) and (ii)	Impact of the minimum requirement, and any proposed harmonised levels of the minimum requirement on: (i) Financial markets in general and markets for unsecured debt and derivatives in particular (ii) Business models and balance sheet structures of institutions, in particular the funding profile and funding strategy of institutions, and the legal and operational structure of groups
Impact on markets and institutions, including on profitability, pricing and capacity in debt markets, financial innovation, asset encumbrance and capacity to raise funding	
45(20)(a)	Impact of the minimum requirement, and any proposed harmonised levels of the minimum requirement on financial markets in general and markets for unsecured debt and derivatives in particular, profitability of institutions, etc.
45(20)(c)	Capacity of institutions to independently raise capital or funding from markets in order to meet any proposed harmonised minimum requirements
Calculation of MREL and consistency with other regulatory requirements, including the choice of denominator and interaction with own funds, leverage and liquidity requirements	
45(19)(h)	Whether changes to the calculation methodology provided for in this Article are necessary to ensure that the minimum requirement can be used as an appropriate indicator of an institution's loss-absorbing capacity
45(19)(i)	Whether it is appropriate to base the requirement on total liabilities and own funds and in particular whether it is more appropriate to use the institution's risk-

	weighted assets as a denominator for the requirement
45(20)(b)	Interaction of the minimum requirements with the own funds requirements, leverage ratio and the liquidity requirements laid down in Regulation (EU) No 575/2013 and in Directive 2013/36/EU
Consistency with international standards	
45(20)(d)	Consistency with the minimum requirements relating to any international standards developed by international fora
Intragroup issues, including the location of loss-absorbing capacity and the conditions for waivers of the MREL for group entities	
45(19)(j)	Whether the approach of this Article on the application of the minimum requirement to groups is appropriate, and in particular whether the approach adequately ensures that loss-absorbing capacity in the group is located in, or accessible to, the entities where losses might arise
45(19)(k)	Whether the conditions for waivers from the minimum requirement are appropriate, and in particular whether such waivers should be available for subsidiaries on a cross-border basis
Adequacy of loss absorbency, including discussion of calibration, eligibility, and the role of DGS contributions	
45(19)(f)	Appropriate transitional period for institutions to achieve compliance with any harmonised minimum levels prescribed
45(19)(g)	Whether the requirements laid down in Article 45 are sufficient to ensure that each institution has adequate loss-absorbing capacity and, if not, which further enhancements are needed in order to ensure that objective
45(19)(l)	Whether it is appropriate that resolution authorities may require that the minimum requirement be met through contractual bail-in instruments, and whether further harmonisation of the approach to contractual bail-in instruments is appropriate
45(19)(m)	Whether the requirements for contractual bail-in instruments are appropriate
Disclosure and reporting, including the appropriateness, form and frequency of MREL disclosure	
45(19)(n)	Whether it is appropriate for institutions and groups to be required to disclose their minimum requirement for own funds and eligible liabilities, or their level of own funds and eligible liabilities, and if so the frequency and format of such disclosure

Annex 2: Policy approach of EU resolution authorities to MREL implementation and calibration

	SRB (SRMR, RTS on MREL)[168]	United Kingdom (8 November 2016 statement of policy)[169]	Sweden (26 April 2016 consultation)[170]
1. Criteria for determination	Case-by-case approach based on the RTS on MREL, which further specifies the criteria laid down in the BRRD.	MREL will be set on the basis of three broad resolution strategies. Insolvency: No additional MREL beyond current minimum capital requirements. Partial transfer: The recapitalisation component of MREL scaled to reflect the size of transfer, and subordination not required where only preferred deposits are to be transferred. Bail-in: Assume recapitalisation of the whole balance sheet, and subordination required with a requirement for structural subordination and contractual subordination for building societies. Indicative boundaries between strategies: Bail-in where balance sheets are greater than GBP 15-25 billion (or EUR equivalent), insolvency where a firm is not systemically important and provides limited critical economic functions, particularly fewer than	MREL would be set based on resolution strategy. Whole bank bail-in: MREL would be set according the institution's current RWA level. This resolution strategy would apply for at least the 4 largest Swedish institutions (i.e. all the Swedish G-SIBs and D-SIBs). Partial transfer: MREL would be set according to the level of RWAs associated with the institution's critical functions. No decision on how many institutions would be in this category. Insolvency: MREL would be equal

[168] The SRB has not yet decided on its position on a number of issues. Therefore, the comparison contained in this summary table is subject to change.

[169] http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf.

[170] https://www.riksgalden.se/Dokument_eng/financial%20stability/mrel-consultation-paper.pdf.

	SRB (SRMR, RTS on MREL)[168]	United Kingdom (8 November 2016 statement of policy)[169]	Sweden (26 April 2016 consultation)[170]
		40 000 to 80 000 transactional deposit accounts (defined as an account with at least 9 withdrawals in a 3-month period). Actual strategies will be set on a firm-by-firm basis.	to existing capital requirements. Institutions that are deemed non-systemically significant according to the assessment in Article 4 of the BRRD (simplified obligations) are assumed to fall in this category.
2. Interaction with capital buffers	Article 12(6) of the SRMR states that MREL shall not be inferior to the total amount of any own funds requirements and buffer requirements under the CRR.	The PRA has published its policy[171] that firms should not count CET1 towards meeting MREL and capital buffers simultaneously. This would mean that buffers would need to be met separately from MREL. Depending on their business model and liability structure, firms may need to increase financial resources to avoid the double-counting of CET1.	The SNDO's MREL model enables the buffers to maintain their function and 'sit on top' of the MREL requirement.
3a. Calibration: Loss absorption	The SRB follows the RTS on MREL, with the loss absorption amount being set at the minimum prudential requirement (including buffers) required on a going concern basis. The SRB may make potential upward or downward adjustments on a case-by-case basis, taking into account, inter alia, SREP information, barriers or impediments to resolvability and other relevant information.	In line with the PRA's policy on the interaction between buffers and MREL, buffers will not be included in the loss absorption component (they will sit on top of and be met separately from MREL). The same approach will be adopted for all firms entering insolvency (including Financial Conduct Authority (FCA) sole regulated investment firms) to align MREL with minimum capital requirements.	The SNDO proposes that the going concern buffers and the macroprudential risks component of Pillar 2 should be excluded from the loss absorption amount.
3b. Calibration: Recapitalisation	The SRB follows the RTS on MREL but distinguishes the RCA from an MCC. The RCA is equal to the minimum	Insolvency: No recapitalisation component. Partial transfer: Recapitalisation component scaled down to match expected size of transfer. Anticipate	Insolvency: No RCA required. Bail-in and partial transfer strategies: The SNDO assumes that

[171] http://www.bankofengland.co.uk/pra/Pages/publications/ps/2016/ps3016.aspx

	SRB (SRMR, RTS on MREL)[168]	United Kingdom (8 November 2016 statement of policy)[169]	Sweden (26 April 2016 consultation)[170]
	prudential requirements, excluding buffers. The MCC is partially commensurate to the CBR (CBR - 125 bps). Further analysis will be conducted at a later stage. The SRB will perform a case-by-case analysis to adjust the requirements based on the resolution strategy and critical functions that need to be preserved.	that retail preferred and covered deposits will be transferred but no other deposits or any senior non-preferred liabilities. Bail-in: Full balance sheet assumed for recapitalisation. For both partial transfer and bail-in: - Adjustments to the discretionary requirements applicable after resolution (Pillar 2A) will be considered on a case-by-case basis; - Buffers will generally not be included in RCA. This preserves the buffers' purpose of providing going concern loss absorbency.	all currently applicable capital requirements, including buffers, would still be applicable after resolution. The RCA would be calibrated to ensure that the full capital requirements, including buffers, can be met after resolution (i.e. no deductions).
4a. Eligibility: Subordination	Expectation for G-SIBs to comply with the TLAC term sheet with respect to subordination. No general subordination requirement for MREL for other banks. However, the SRB may review feasibility and credibility of bailing-in instruments on a case-by-case basis.	Subordination of MREL required for all firms with a bail-in strategy. Structural subordination of MREL via HoldCo issuance (which is downstreamed to operating bank companies in the form of capital or subordinated debt liabilities) will generally be required, except for mutually owned firms that cannot operate with HoldCos (United Kingdom building societies). Such firms that have a bail-in strategy will be required to subordinate their MREL contractually.	The SNDO has yet to decide how much of institutions' total MREL requirements need to be met with subordinated instruments. However, the consultation document sets a strong preference that MREL be met to a certain level with subordinated instruments. The proposed calibration of this level will be consulted on in Q1 2017.
4b. Eligibility: Maturity	No additional hard maturity requirements beyond the minimum 1-year residual maturity requirement in the BRRD.	No additional maturity requirements beyond the minimum 1-year residual maturity requirement in the BRRD, but an expectation that firms will monitor their overall MREL maturity profile and be resilient to temporary market access issues.	The SNDO has indicated that it is considering whether the average maturity of MREL instruments should be subject to certain minimum requirements. No

	SRB (SRMR, RTS on MREL)[168]	United Kingdom (8 November 2016 statement of policy)[169]	Sweden (26 April 2016 consultation)[170]
			decisions have been made at this stage.
4c. Eligibility: Other issues	Article 12(16) of the SRMR specifies the conditions that eligible liabilities must satisfy in order to be included in MREL. All third-country liabilities must include contractual recognition of bail-in tools. Liabilities with embedded derivative components, including structured notes, do not count towards MREL.	Liabilities for which the value is dependent on embedded derivatives, including structured notes, are not eligible for MREL. Liabilities that only include put or call options are not considered to be dependent on derivatives for this purpose.	At this stage, no additional requirements beyond the BRRD minimum criteria have been set.
5a. Location: Consolidated	The SRB's intention is to provide informative MREL targets for all major banking groups under its remit before the end of 2016, but only on a consolidated level.	Consolidated MREL will be set in line with the RTS on MREL framework and the Bank of England's calibration proposals.	In 2016, the SNDO will prioritise MREL decisions at the consolidated level.
5b. Location: Solo entities within groups	The SRB does not intend to set MREL for subsidiaries on an individual basis in 2016 but plans to do so at a later stage. SRB intends to base the MREL targets for subsidiaries on their individual characteristics and the consolidated level, which has been set for the group (Article 12(9) of the SRMR) and considering the possibility of waivers (Article 12(10) of the SRMR).	Individual entity MREL will be set later in the transitional period. For firms subject to structural subordination, individual operating entities will be required to issue subordinated liabilities to the group resolution entity to meet their individual MREL. In line with the TLAC term sheet, for material subsidiaries (including domestic subsidiaries) of G-SIBs, the Bank of England will endeavour to set the requirement at 75%-90% of what the requirement would have been had they been resolution entities. The Bank of England is considering an exception to this by requiring 100% for domestic 'ring-fenced bank'	For groups with SPE strategies, subsidiaries' MREL should be met with internal instruments. The SNDO will communicate (at a later date) what characteristics such internal instruments should have (i.e. should they be subordinated, trigger mechanisms, etc.).

	SRB (SRMR, RTS on MREL)[168]	United Kingdom (8 November 2016 statement of policy)[169]	Sweden (26 April 2016 consultation)[170]
		entities/subgroups.	
5c. Location: HoldCos	Not specified in the SRMR or the RTS on MREL.	Firms subject to structural subordination will be set an individual MREL at the HoldCo level, to ensure sufficient external MREL resources are issued by the resolution entity. A consolidated requirement would not necessarily be sufficient to achieve this.	Not applicable in the Swedish context.

6. Transitional arrangements	Not specified.	Final transitional deadline is 1 January 2022. Firms will be expected to meet the following interim requirements:
		• 2019: G-SIBs must meet the 16%/6% of TLAC minimum;
		• 2020:
		  ○ G-SIBs and D-SIBs with a bail-in resolution strategy: 2 x (P1 + P2A) or 2 x leverage ratio;
		  ○ Other bail-in and partial transfer firms: 18% of RWAs or 2 x any applicable leverage ratio;
		  ○ Modified insolvency: MREL will be set at the level of regulatory capital requirements, as these firms will not be required to hold recapitalisation MREL.
		The final calibration and transition of the end state (2022) requirement will be reviewed no later than the end of 2020.
		Generally, the Bank of England will not set
			The MREL requirement should be met by Q4 2017 on the basis of debt instruments that meet the minimum BRRD eligibility criteria (i.e. senior unsecured debt may be included).
			Once a decision has been taken on the level of MREL that should be met with subordinated instruments, a separate transitional period will be set for compliance with that requirement.

	SRB (SRMR, RTS on MREL)[168]	United Kingdom (8 November 2016 statement of policy)[169]	Sweden (26 April 2016 consultation)[170]
		requirement above regulatory capital requirements until the interim requirements apply, although it may do so in individual cases.	

Annex 3: Comparison between MREL, the TLAC term sheet and US/Swiss planned implementation of TLAC

	TLAC term sheet	USA/Swiss proposals	MREL
Scope	G-SIBs and their material subsidiaries. External TLAC requirement set for each resolution entity; iTLAC requirement set for each material subgroup.	USA: US G-SIBs and intermediate holding companies (IHCs) of foreign G-SIBs. CH: G-SIBs.	1. Credit institutions and investment firms on a consolidated and solo basis. 2. HoldCos and other affiliated financial institutions (optional).
Calibration – Minimum	From 1 January 2019: At least 16% of RWAs (plus buffers) and > 6% of leverage exposure. From 1 January 2022: At least 18% of RWAs (plus buffers) and > 6.75% of leverage exposure. See also the section below on firm-specific requirements.	USA: TLAC > 18% of RWAs and > 9.5% of leverage exposure (from 2022). Long-term debt > 6% + G-SIB surcharge of RWAs; 4.5% of total leverage. For foreign G-SIB IHCs TLAC > 16% of RWAs, 6% of leverage exposure (if subject to the supplementary leverage ratio (SLR)), and 8% of total assets (if not subject to the SLR); long-term debt > 7% of RWAs, 3% of leverage, 4% of assets. The requirements mentioned above	No harmonised minimum requirement; six firm-specific criteria set out in the BRRD relating to the resolution strategy. RTS on MREL: Resolution authorities to determine an appropriate transitional period which is 'as short as possible'. SRB: Generally expect most institutions under the SRB remit to have MREL of at least 8% of TLOF.

		are for SPE IHCs. For an MPE firm, the requirements are: TLAC/RWAs of 18%; TLAC/leverage exposure of 6.75% (if subject to the SLR); and TLAC/average total assets of 9%. CH: > 28.6% of RWAs (o/w 10% of CET1, 4.3% of T1, 14.3% of other); > 10% of leverage exposure (o/w 3.5% of CET1, 1.5% of T1, 5% of other).	
Calibration – Firm-specific requirements	Additional firm-specific requirements if necessary and appropriate to implement resolution, minimise impact on financial stability, ensure continuity of critical functions, or avoid exposing public funds to loss.	Not discussed.	MREL is a firm-specific requirement, based on ensuring that firms have sufficient loss-absorbing capacity to implement the preferred resolution strategy, size and risks, DGS contribution, and impact on financial stability. RTS on MREL: It is necessary to assess: a) Loss absorption amount (starting from own funds requirements); b) RCA (starting from own funds requirements); c) Adjustments for DGS contributions and excluded liabilities. Denominator of MREL is total own funds and liabilities, but the MREL requirement should be set as an amount. SRMR: At least equal to own funds (buffers included) (see Article 12.6 of SRMR).

			SRB currently expects most SRB institutions to have MREL of at least 8% of TLOF (still under discussion).
Denominator	RWA/leverage ratio denominator of the resolution group.	RWA and leverage ratio denominator.	TLOF at the individual and the consolidated levels.
Arrangements for groups, including internal requirements	External TLAC requirement for the resolution entity to be set in relation to the consolidated balance sheet of each resolution group. iTLAC must be set for each material subgroup at 75%-90% of the external TLAC requirement that would apply if that material subsidiary were the resolution entity. The calibration within the 75%-90% range is decided in discussions within the Crisis Management Group (CMG). iTLAC can be in the form of collateralised guarantees subject to conditions. TLAC that is not prepositioned should be readily available to recapitalise any direct or indirect subsidiary as necessary to support the execution of the resolution strategy. No mandatory requirement for domestic iTLAC, but it can be imposed by authorities on a discretionary basis.	USA: The Federal Long-Term Debt Requirement proposes that US IHCs of foreign G-SIBS will have to meet an 89% iTLAC requirement. Seeking comment on domestic iTLAC. For MPE IHCs, the iTLAC requirement would be 100%. CH: No specification in the October 2015 announcement on the implementation of TLAC. Seeking comment on domestic iTLAC.	MREL for the group on a consolidated basis. MREL must be set for all credit institutions and investment firms within groups on an individual entity basis, and be set with regard to consolidated MREL and the group resolution strategy. There is limited possibility of waivers when the institution and the parent are in the same Member State. There is no requirement to issue at least as much external MREL as the sum of internal MREL.

	The resolution entity should issue and maintain at least as much external TLAC as the sum of iTLAC (which it has provided or committed to provide) and any TLAC needed to cover material risks on the resolution entity's own balance sheet. However, external TLAC may be lower if—and to the extent that—this is due to consolidation effects only.		
Relationship with capital buffer requirements	CET1 capital cannot count simultaneously towards both TLAC and regulatory capital buffers.	USA and CH: CET1 capital cannot count simultaneously towards both TLAC and regulatory capital buffers.	Capital instruments count towards MREL. Relationship between MREL and buffers not specified in the BRRD. MREL is a minimum requirement that 'must be met at all times'.
Penalties for breach	Restrictions for breach due to maturing instruments mirroring restrictions for breach of buffer requirements due to maturing Tier 2 instruments. Breach should be treated as seriously as a breach of minimum regulatory capital requirements.	Not specified.	Not specified in the BRRD. Options available include: • Triggering powers to remove impediments to resolvability; • Triggering early intervention powers; • Administrative penalties under Article 110 of the BRRD; • General supervisory powers and penalties for any associated breach of capital requirements.
Eligibility – Remaining maturity	> 1 year. The maturity profile should be adequate in case access to capital markets is impaired.	USA: > 1 year; possible 50% haircut on < 2 years (it is proposed that this will only be applied for the long-term debt requirement, not the TLAC	> 1 year

		requirement). CH: TBC.	
Eligibility – Subordination	External TLAC must be subject to contractual, statutory or structural subordination (relative to excluded liabilities on the balance sheet of the resolution entity). Exemptions may apply if they would not result in material risk of successful legal challenge or compensation claims: a) If excluded liabilities pari passu or junior to TLAC liabilities < 5% of external TLAC (and exclusion is possible and would not affect resolvability); b) If all liabilities excluded from TLAC are statutorily excluded from the scope of bail-in; c) (Up to 2.5% of RWAs, rising to 3.5% in 2022) if the resolution authority has the discretion to exclude from a bail-in all the liabilities excluded from TLAC.	USA: Issuing HoldCo must meet 'clean HoldCo' requirements. Debt instruments must be: a) Unsecured; b) Not self-guaranteed; c) Not subject to other enhancement of seniority. CH: TBC.	No requirement in Level 1, but the resolution authority may require part of MREL to be met by subordinated bail-in instruments. The resolution authority may also require establishment of HoldCo under Article 17 of the BRRD. RTS on MREL: It must assess whether the resolution would breach the NCWO principle (due to too much excluded liabilities versus MREL-eligible liabilities within or junior to a certain class) and recalibrate MREL accordingly or require alternative measures, unless below the de minimis threshold (10% of a given class).
Eligibility – Other instrument characteristics	The following are excluded from TLAC: a) Insured deposits; b) Deposits w < 1-year maturity; c) Derivatives;	USA: Debt instruments subject to plain vanilla requirements, excluding: a) Structured notes; b) Credit-sensitive features; c) Convertibles;	Resolution authorities may require contractual bail-in instruments. The following liabilities are excluded on a mandatory basis:

	d) Structured notes; e) Non-contractual liabilities; f) Preferred liabilities; g) Liabilities exempt from bail-in. Liabilities must be paid in, unsecured, not subject to contractual set-off or netting, not redeemable, not self-funded.	d) Acceleration clauses.	a) Liabilities arising from derivatives; b) Liabilities must be paid up, unsecured, not self-funded (issued or guaranteed); c) Preferred deposits; d) Liabilities excluded from bail-in: a. Covered deposits; b. Secured; c. Client money/asset; d. Fiduciary liability; e. Interbank and < 7 days; f. Arising from recognised payment/settlement system participation and < 7 days; g. To employees (except variable compensation), commercial or trade creditors in critical services, tax authorities, or DGSs.
Eligibility – Contractual triggers	External TLAC must contain—absent any statutory mechanism—contractual trigger allowing the resolution authority to write-down or convert in resolution.	No mandatory contractual triggers.	No mandatory contractual triggers, except for third-country law governed liabilities.
Eligibility – Jurisdiction	Must generally be subject to governing law of the jurisdiction of the resolution entity. If issued under the law of another jurisdiction, must ensure the application of resolution tools is effective and enforceable.		All third-country liabilities must include contractual recognition of bail-in tools.

Eligibility – Issuer	TLAC must be directly issued by a resolution entity except CET1 recognised in consolidated capital and regulatory capital instruments issued by cooperative banks within an Institutional Protection Scheme (IPS). Minority interest other than CET1 allowed until 31 December 2021. There is an exception for wholly owned funding vehicles on a temporary basis (until 2022).	USA: Issued directly by the HoldCo.	Individual level MREL requirements apply. Those requirements would need to be met by issuance by the entity to which they apply.
Other restrictions on composition	Expectation that one third of TLAC is non-equity.	USA: Long-term debt requirement applies in parallel. TLAC issued by foreign G-SIB IHCs must be issued to parent.	None.
Other features – Exposures to TLAC/MREL instruments	BCBS proposal on deductions from capital under consultation.		Not harmonised.
Other features – Disclosure and reporting	BCBS disclosure template.		Not harmonised, but national/Banking Union requirements may apply.
Conformance period	1 January 2019 – First phase. 1 January 2022 – Second phase.		Resolution authorities shall determine an appropriate transitional period, which is as short as possible.

Annex 4: Summary of the responses to the public consultation on the MREL interim report

From 19 July 2016 to 30 August 2016, the EBA consulted the public on its interim report on the implementation and design of MREL. The EBA invited interested stakeholders to provide written comments to specific questions that were related to: (i) the reference base for the MREL requirement, (ii) the relationship with regulatory requirements, (iii) the response to a breach of MREL, (iv) the adequacy and calibration of the MREL requirement, (v) MREL eligibility, and (vi) third-country recognition of resolution actions. In addition to the written public consultation procedure, the EBA organised three meetings with bank federations, market analysts and investors and consumer and civil society organisations.

Figure 30: Distribution of responses by type of respondent

Twenty-nine written responses were received with regard to the public consultation from a large variety of stakeholders. Approximately half of the respondents were associations representing banks. In addition, six banks (of which four were G-SIBs) responded directly. The remainder of the responses were received from various types of organisations, such as capital markets associations, a rating agency, a stock exchange and the EBA's Banking Stakeholder Group.

(i) Reference base for the MREL requirement

The change of the reference base of MREL from TLOF to RWAs (complemented with a leverage ratio exposure backstop) was supported by a large majority of the respondents. Some of the respondents agreed with the reference base change but stated that the leverage exposure backstop measure effectively might act as a stand-alone measure. In addition, a few respondents mentioned that an increase in RWAs due to potential future regulatory reforms needs to be taken into account when setting MREL.

(ii) Relationship with regulatory requirements

The EBA suggested that the usability of regulatory capital buffers would be best preserved if they stack on top of MREL. Respondents generally agreed with the stacking of CET1 buffers. Some of them noted that the calibration of MREL should take the prohibition of double-counting into account. A large majority of respondents stated that a breach of MREL should not result in any automatic consequences, especially MDA restrictions.

Several respondents agreed with the proposed interaction between MREL and the NFSR. However, they raised the concern that the interaction between internal MREL and the NSFR could give rise to further issues—i.e. funding being 'trapped' in subsidiaries while there is an eventual funding shortfall at the parent level.

The respondents argued that the early redemption of MREL instruments should not require prior regulatory approval, on the basis that such an approval process would be too time-consuming and burdensome. In circumstances where a redemption approval requirement was to be introduced, respondents agreed that such an approval requirement should only be necessary if the proposed redemption would result in a breach of MREL.

(iii) Response to a breach of MREL

Almost all respondents stated that automaticity with respect to a breach of MREL should be avoided. Respondents believed that there should not be an automatic assessment of whether an institution is failing or likely to fail or any automatic MDA restrictions. There was general agreement that a breach of MREL has to be considered on a case-by-case basis by resolution authorities and competent authorities. Several respondents suggested that there should be a grace period before a breach response is allowed, so that institutions could attempt to reissue MREL-eligible instruments. A number of respondents noted that a breach of MREL has to be evaluated together with other capital requirements (i.e. capital breach).

(iv) Adequacy and calibration of the MREL requirement

A majority of respondents agreed that the essential driving factor in determining MREL is the resolution strategy and this should respect banks' business models. A number of respondents emphasised the necessity of aligning the MREL framework with the FSB TLAC term sheet. There were mixed views on whether the TLAC standards should be extended beyond G-SIBs.

(v) MREL eligibility

The respondents were generally in favour of the recommendations and particularly supported clarity on the creditor hierarchy for investors. Furthermore, most respondents agreed that all three forms of subordination should be permitted and the focus was appropriately placed on the specification of subordination outcomes.

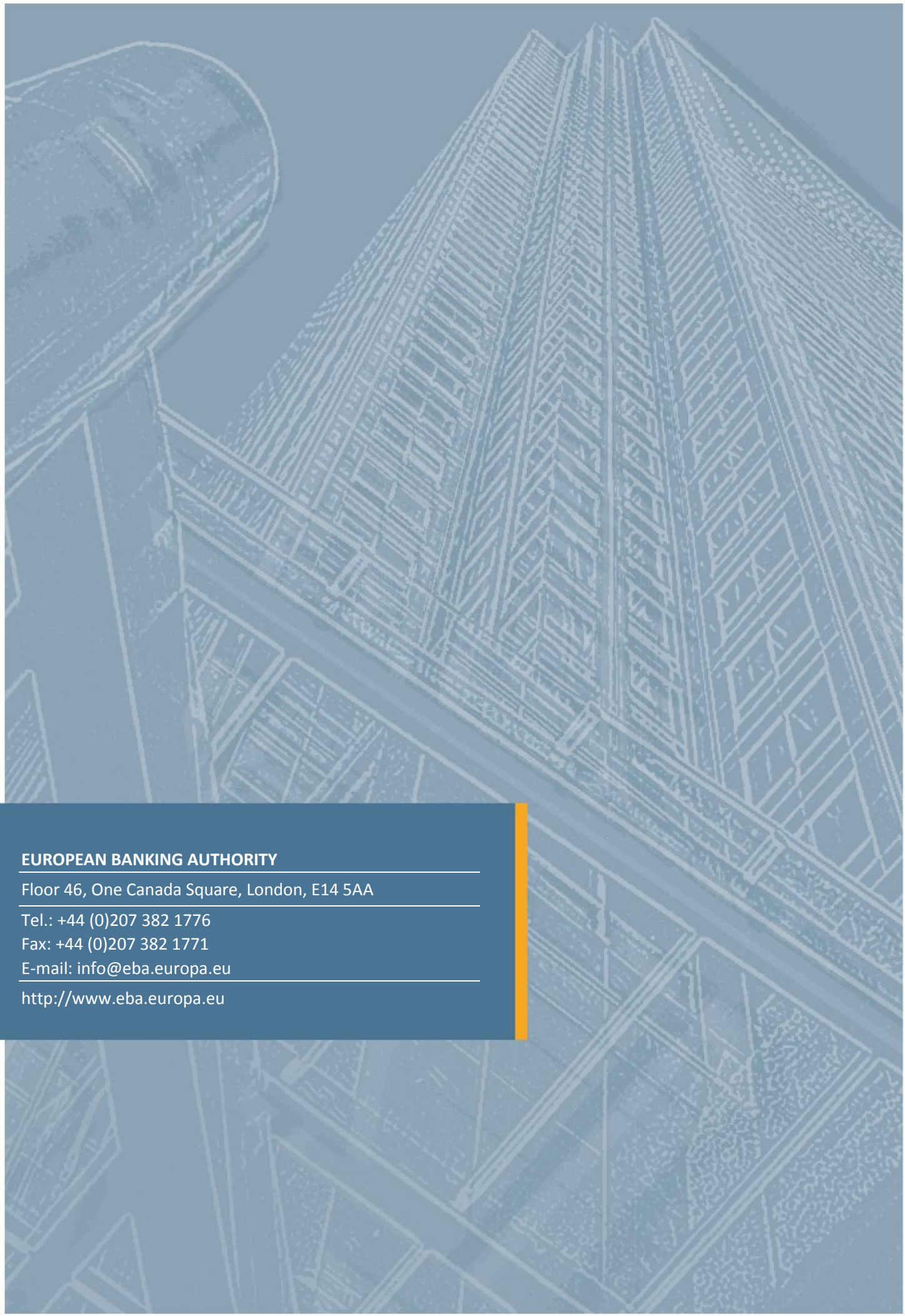
With respect to the scope of subordination, there were a broad variety of answers. Several respondents stated that mandatory subordination should only apply to G-SIBs, while others believed that the matter of subordination should be assessed on a case-by-case basis. A few respondents asserted that a subordination requirement in line with the TLAC standards should be generally put in place. The maintenance of the TLAC subordination exemption (2.5%/3.5% of RWAs) was noted to be important by a number of respondents.

Most respondents favoured the publication of information on statutory creditor hierarchies. In addition, some respondents suggested that there should be disclosure of information on banks' balance sheet structures. Several respondents stated that if the MREL requirement is disclosed at all, this should only happen after a transitional period.

(vi) Third-country recognition of resolution actions

Almost all respondents stated that the current scope of Article 55 of the BRRD is too broad and makes the compliance unnecessarily burdensome without improving banks' loss-absorbing capacity. It was pointed out that, for many types of contracts, the required clauses could not be included due to practical reasons or the refusal of the other parties regarding the contract. In that regard, a number of respondents pointed to particular difficulties with respect to the trade finance business.

Overall, a large majority of respondents proposed the limitation of the scope of Article 55 to MREL-eligible liabilities only. In addition to this limitation to eligible liabilities, some respondents requested that resolution authorities should be able to grant waivers from the requirement to comply with Article 55.



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