EBA EUROPEAN BANKING AUTHORITY

Draft Technical Standards on criteria for MREL

19 January 2015

Contents

1. Context: BRRD requirements

- The BRRD provides a common resolution regime to deal with failing institutions as well as ensuring cooperation between home and host authorities.
- Shareholders and creditors will have to internalise the burden of bank failure, minimizing moral hazard and risks to taxpayers.
- To prevent institutions structuring their liabilities in a way that impedes the effectiveness of resolution institutions must meet at all times a robust minimum requirement for own funds and eligible liabilities (MREL)
- This is to be set on a case-by-case basis by resolution authorities, based on at least six common criteria set out in the BRRD.
- EBA is mandated to further specify these criteria

1. Context: BRRD requirements

These criteria are described in Article 45 (6) of the BRRD, and are:

- *Resolvability*: RA must ensure the institution is resolvable
- *Capital*: sufficient eligible liabilities to i) absorb losses, ii) restore CET1 ratio to a level sufficient to be authorised, iii) sustain market confidence
- *Exclusions:* take account of any liabilities which the resolution plan anticipates might be excluded from bail-in
- *Deposit guarantee scheme*: take account of possible contributions to resolution costs from the DGS
- *Risk*: size, business model, funding model, and risk profile
- *Systemic risk*: extent to which failure would affect financial stability

1. Context: general approach

- Seek to ensure that similar levels of MREL are set for institutions with similar risk profiles, resolvability, and other characteristics

- Seek to describe how resolution authority and supervisory judgements should be related to each other

- Seek to clarify link to resolution planning process and measures to address impediments to resolution

2. Main features of the draft Technical Standards

Resolvability and capital

- Resolution authorities should determine a) an amount of losses which the institution should be able to absorb and b) an amount of recapitalisation needed to maintain authorisation and sustain market confidence
- Starting point for both should be the regulatory capital (and leverage) requirements
- Differences from these should be clearly reasoned
- *Question*: should all elements of capital (e.g. buffers, pillar 2) be included?

2. Main features of the draft Technical Standards

Resolvability and capital

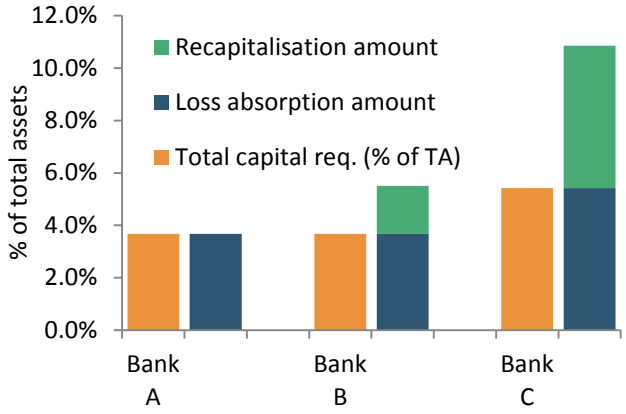
- Amount of loss absorption may be different from capital requirements if judgement on risk is different, but this should be supported by a reasoned explanation
- May also be different if necessary to address impediments to resolvability – e.g. to address exclusions from bail-in
- Amount of recapitalisation may be different from capital requirements if resolution would credibly change the amount of assets/RWAs – e.g. by leaving the bank smaller. NB can be zero for a bank to be liquidated.
- Capital needed should also be benchmarked to peers (at least for systemic banks)

2. Main features of the draft Technical Standards

Bank A: small bank which would be liquidated – no capital requirements after resolution

Bank B: medium-sized bank, half liquidated & half continues – capital requirements halved after resolution

Bank C: large, complex bank only suitable for 'full bank' bail-in – no reduction in capital requirements



2. Main features of the draft Technical Standards

This baseline assessment may need to be adjusted to reflect the

additional criteria:

- Adjustment for liabilities which are *de jure* exempt from bail-in or less likely to be bailed in (essential for critical functions, contagion risk) and:
  - count towards MREL; or
  - rank pari passu with MREL liabilities ('No Creditor Worse Off' safeguard)
- Adjustment for deposit guarantee scheme contribution
- For systemic firms, need to consider that resolution funds can only be accessed after burden sharing of at least 8% of total assets has taken place

Resolution authority also needs to set transition schedule (proposed limit

2. Main features of the draft Technical Standards

Exemptions

- Liabilities may not be bailed in either because: a) they are exempted from bail-in under BRRD Article 44(2) or b) the resolution decides it may exclude them because they are more difficult to bail in (Article 44(3))
- EBA RTS on resolution planning requires resolution authorities to identify and quantify such liabilities
- Excluding some liabilities means a larger bail-in for *pari passu* liabilities not excluded – if large share of liabilities excluded, may breach No Creditor Worse Off
- MREL should be adjusted where this is likely to be the case

2. Main features of the draft Technical Standards

Systemic risk

- Resolution fund can only be used to indirectly absorb losses after burden-sharing of at least 8% of total liabilities and own funds
- Resolution fund is only for exceptional circumstances – failure of a systemic bank may constitute such circumstances
- Authority should therefore consider whether the proposed MREL requirement for a systemic bank is sufficient to meet this burden-sharing test

2. Main features of the draft Technical Standards

Deposit Guarantee Schemes

DGS covers losses to covered deposits in event of liquidation

BRRD also permits DGS to contribute to the cost of resolution, up to the lower of:

- The amount by which covered deposits would have been written down if not protected by the DGS
- 50% of its target funding level (or another percentage set by the member state)

This can be a substitute for part of the MREL

2. Main features of the draft Technical Standards

Transition

- Reasonable and desirable to set a transitional path for MREL
- Draft RTS proposes four years as a reasonable time period for transition
- *Question:* Should there be a different (shorter) period for restoring MREL after resolution occurs?

2. MREL and TLAC

- MREL has same goal as FSB TLAC: to ensure that banks internalise costs of failure by requiring them to have sufficient resources to absorb losses and recapitalise without public support (restoring market discipline ex ante, and breaking the vicious circle)
- Essential to maintain home/host cooperation in the single market.
- One key difference is that MREL applies in principle to all banks in the EU
- Therefore needs to be calibrated on a case-by-case and has no common 'pillar 1' minimum
- However, also TLAC has a pillar 2 case-by-case component

2. MREL and TLAC

Similar structure of requirements, e.g. 1 year residual maturity of instruments, option to require subordinated bailinable instruments in MREL

Some differences from TLAC:

- No general subordination requirement for MREL (but resolution authorities must review feasibility and credibility of bailing-in instruments)
- Denominator: MREL is set as a % of total assets, not RWAs or leverage exposure (but since no common minimum can adjust for this)
- Capital buffers: capital buffers sit on top of TLAC.
- Implementation date: MREL already in law (but can allow transition by setting case-by-case requirements)
- Scope: TLAC proposal also covers rules on holding of TLAC instruments and composition of TLAC (minimum non-equity component)
- Disclosure: TLAC proposal has specific rules to foster market discipline and pricing
- Internal TLAC: specific rules on pre-positioning of TLAC among foreign jurisdictions

Proposed specification would allow EU authorities to set MREL for G-SIBs in a way that is consistent with the proposed TLAC standard. Additionally there is a review clause for the MREL legislation in 2016.

3. Process and next steps

Consultation process

- Consultation period closes on 27 February 2015
- Draft RTS will be reviewed in light of consultation responses
- Final draft RTS approved by the EBA (Resolution Committee/Board of Supervisors) then submitted to Commission for adoption

4. Questions

1. Are any components of the overall capital requirement not appropriate indicators of loss in resolution?
2. Should the resolution authority adjust the loss absorption amount downwards from the level of capital requirements?
3. Should any additional benchmarks be used to assess the necessary degree of loss absorbency?
4. Are any components of the overall capital requirement not appropriate indicators of the capital required after resolution
5. Is it appropriate to have a single peer group of G-SIIs, or should this be subdivided by the level of the G-SII capital buffer? Should the peer group approach be extended to Other Systemically Important Institutions (O-SIIs)/other institutions?
6. Are there additional ways in which specific features of subsidiaries should be reflected?
7. Do you agree with the derogation for excluded liabilities which account for less than 10% of a given insolvency class?
8. Do you agree that resolution authorities should seek to ensure that systemic institutions have sufficient MREL to make it possible to access resolution funds fully?
9. Is the limit on the transition period appropriate?
10. Should the resolution authority also set a transitional period for the MREL of banks which are undergoing or have undergone a resolution process?
11. Overall, do you consider that the draft RTS strikes the appropriate balance between the need to adapt the MREL to the circumstances of individual institutions and promoting consistency in the setting of adequate levels of MREL across resolution authorities?
12. Are there additional issues which should be considered in the final impact assessment?

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