



MREL : Approach taken in 2016 and next steps





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Keywords: MREL, TLAC, SRB, SRM

EXECUTIVE SUMMARY

Context

- 1 The Single Resolution Board (SRB) is the resolution authority for participating Member States within the Banking Union (BU). It began operating as an independent European Union (EU) agency on 1 January 2015. The SRB assumed its full legal powers for resolution planning and resolution decisions on 1 January 2016. Its primary scope covers significant and cross-border banking groups established in the BU.
- 2 The Bank Recovery and Resolution Directive (BRRD), which has been transposed in all participating Member States, requires banks to meet a minimum requirement for own funds and eligible liabilities (MREL) so as to be able to absorb losses and restore their capital position, allowing banks to continuously perform their critical economic functions during and after a crisis.
- 3 To achieve this outcome, the SRB, together with the BU national resolution authorities (NRAs), has started to develop its MREL approach in 2016. Its preliminary approach consisted of informative targets that sought to enable banks to prepare for their future MREL requirements.
- 4 The SRB determined that a final MREL methodology would not be available in 2016 for two main reasons. MREL is not a common regulatory standard but more a Pillar 2 instrument, driven by the risk and resolvability profiles of each institution. This means that developing a methodology covering all relevant aspects represents a considerable challenge given the wide range of banking groups in participating Member States. In addition, the current rules, only clarified in May 2016 when the European Commission (EC) adopted its Delegated Regulation (DR) on MREL¹, are likely to change following the release of the EC's legislative proposal on Total Loss Absorbing Capacity (TLAC) and MREL² in November 2016. However, the SRB is committed to ensuring that it can resolve banks without significant negative impacts on financial stability, and so banks must therefore have a sufficient and adequate level of MREL.

Target level and location

- 5 The SRB's informative MREL targets are based on the EC DR default formula:
 - i) a default loss absorbing amount (LAA) that consists of the higher of:
 - (a) the aggregate of a bank's minimum capital requirement (Pillar 1); its Pillar 2 requirement; and its fully-loaded combined buffer requirement (CBR); or

¹ [Link](#)

² [Link](#)

- (b) the amount that is required to meet the Basel 1 floor;
- ii) a recapitalization amount (RCA) that consists of the higher of:
 - (a) a bank's minimum capital requirement (Pillar 1) and Pillar 2 requirement; or
 - (b) an amount that is required to meet the Basel 1 floor.

They are complemented by a market confidence charge (MCC) set for 2016 at the level of the fully-loaded CBR less 125 basis points. The leverage ratio was not computed pending the introduction of a final binding requirement into EU law. The calibration of the MCC in 2016 does not set a precedent for the future, and took into account the approach adopted by other resolution authorities in the EU.

- 6 The 2016 informative MREL targets did not take into account any upward or downward adjustments. Changes permitted by the DR may reflect bank-specific features, such as the preferred resolution strategy, its business model, funding and risk profiles as well as the resolvability assessment and adjustments based on any potential contribution from deposit-guarantee schemes (DGS) or the exclusion of liabilities from bail-in.
- 7 The informative MREL targets for 2016 were set at consolidated level only and did not attempt to address at this stage the interplay between entities which form part of the same banking group, i.e. through internal MREL. Furthermore, informative targets have been assessed with bail-in as the main resolution tool in combination with a single-point-of-entry (SPE) strategy. The impact of other resolution tools or a multiple-point-of-entry (MPE) resolution strategy will be considered in 2017.
- 8 In addition to the DR formula, the SRB took into account an eight percent benchmark. The SRB considered that MREL should be set at a level sufficiently prudent to access, if necessary, financing arrangements like the Single Resolution Fund (SRF) in the BU. The SRB considered that an MREL level of at least eight percent of total liabilities and own funds (TLOF) would generally be required for all major banking groups within the BU.
- 9 Being informative, 2016's MREL targets were not shared within resolution colleges. The SRB will refine its methodology in 2017 to calculate binding consolidated targets taking into account resolution strategies and business models. These targets will be discussed within resolution colleges in the fourth quarter of 2017. It is expected that firms will comply with the binding targets at the end of an appropriate transition period. Failure to do so may result in banks being deemed unresolvable following relevant assessments in accordance with applicable legislation. MREL requirements at material entity level will also be defined late 2017/2018 for major banks and banks with resolution colleges.

Quality and phase-in

- 10 The calculation of a bank's available MREL-eligible liabilities in 2016 followed the criteria set out in the BRRD. In 2016, the SRB took a cautious approach to eligibility, excluding structured notes and highlighting the need for further assessment of liabilities issued by special purpose vehicles (SPVs), liabilities governed by the law of a country outside the EU and liabilities issued by entities incorporated outside the EU.
- 11 On the other hand, the SRB included uninsured and non-preferred term deposits with a minimum maturity of at least one year as they are eligible for bail-in under existing legislation. Nevertheless, further analysis of these liabilities is expected to take into account the risk that some of these liabilities might not be there anymore at the point of failure, based on guidance provided by EBA and evidence indicating that bailing in certain forms of deposits may raise concerns.
- 12 Other liabilities held by retail investors were considered as MREL-eligible if they met the eligibility criteria set out in the BRRD. The SRB cannot exclude retail exposures on the basis of the nature of the holder, even when the structure of the institution implies that its capital is owned by its customers. However, the SRB considers that in some cases holdings of instruments by retail investors may constitute an impediment to resolvability, as it may hamper achievement of the resolution objectives specified in the BRRD, especially if it damages a bank's franchise and the continuity of its critical functions.
- 13 With respect to subordination, the SRB considered that Global Systemically Important Institutions (G-SIIs) must meet, at a minimum, a subordination target equal to 13.5 percent of Risk Weighted Assets (RWAs) plus the CBR, assuming compliance with the TLAC standard by 2019. No detailed policy has been adopted yet regarding other systemic banks but the SRB has always considered subordinated instruments to be essential in limiting no-creditor-worse-off (NCWO) issues and ensuring the resolvability of banking groups beyond G-SIIs.

Going forward

- 14 The SRB will develop its MREL policy in 2017 with a view to setting binding MREL targets for the most systemic banking groups in the BU. To this end, the SRB will remain closely involved in the ongoing European legislative process in respect of TLAC and MREL, while refining its MREL approach for 2017 and beyond.
- 15 The SRB intends to develop additional policies and methodologies in respect of MREL, based on existing legislation and other relevant regulatory developments. These will include the calibration of MREL targets, the assessment of eligibility criteria, including subordination, as well as MREL positioning within banking groups and appropriate transition periods for banks in the BU.



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GLOSSARY

BCBS	Basel Committee on Banking Supervision
BRRD	Bank Recovery and Resolution Directive
BU	Banking Union
CBR	Combined Buffer Requirement
CCR	Capital Conservation Buffer
CET1	Common Equity Tier 1
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DGS	Deposit-Guarantee Scheme
DR	Commission Delegated Regulation
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EU	European Union
FOLTF	Failing Or Likely To Fail
FSB	Financial Stability Board
G-SIB	Global Systemically Important Bank (FSB)
G-SII	Global Systemically Important Institution (EU)
KA	FSB Key Attributes
LAA	Loss Absorption Amount
LDT	Liability Data Template
MCC	Market Confidence Charge
MPE	Multiple Points of Entry
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NRA	National Resolution Authority
O-SII	Other Systematically Important Institution
P2G	Pillar 2 Guidance
P2R	Pillar 2 Requirement
RCA	Recapitalization Amount
RWA	Risk Weighted Assets
SME	Small and Medium sized Enterprise
SPE	Single Point of Entry
SPV	Special Purpose Vehicle
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SRM-R	Single Resolution Mechanism Regulation
TLAC	Total Loss Absorbing Capacity
TLOF	Total Liabilities and Own Funds

INTRODUCTION

- 16 **The recent financial crisis was unprecedented in its severity and revealed a lack of tools available to public authorities to impose losses on bank creditors.** The breadth of financial institutions affected by the crisis was exceptional, with a large number of banks bailed out with public funds as they were perceived to be “too big to fail”. In the EU as a whole, 22 Member States provided aid to their financial sectors, and for some, more than fifty percent of the financial system received state support.³
- 17 **The crisis led to the development of new statutory regimes for resolution across the G20 and to the introduction of a new resolution mechanism, the bail-in tool.** The Financial Stability Board (FSB) developed Key Attributes for effective resolution regimes for financial institutions⁴ (KAs) that would allow public authorities to resolve financial institutions in an orderly manner without taxpayer support, while maintaining their critical economic functions. The new bail-in tool was introduced to allow authorities to write down the liabilities of a failing bank and/or convert them to equity should its failure pose a significant risk to financial stability.
- 18 **In the EU, the BRRD was adopted in May 2014 and incorporated the bail-in tool.** The BRRD granted far-reaching powers to resolution authorities to allocate losses and recapitalization needs to a broad scope of creditors through the use of the bail-in tool, out of insolvency. Indeed, in the new regime, only covered deposits, secured liabilities, short-term interbank borrowings, short-term liabilities owed to payment systems and other liabilities owed in respect of employees, taxes, social security obligations and deposit guarantee schemes, provided they are preferred under applicable national law, were explicitly excluded. Additional exclusions can be granted in exceptional circumstances, such as: i) the impossibility of bail-in within a reasonable timeframe; ii) the need to preserve critical functions and core business lines; iii) to avoid widespread contagion that can severely disrupt financial markets causing a serious disturbance to the economy of a Member State or of the Union; or iv) to avoid destruction of value such that losses borne by other creditors are greater than if the exclusion were applied.
- 19 **The BRRD also introduced a minimum requirement for own funds and eligible liabilities.** MREL shall ensure that banks at all times have enough capital and eligible liabilities to facilitate bail-in. It prevents a situation where either due to the funding mix of the bank (e.g. purely deposits or secured funding) or following the consequences of recovery actions ahead of resolution, the resolution authority is unable to apply resolution tools successfully. MREL is a minimum requirement that applies to all institutions, at solo and consolidated level, under a Pillar 2 approach. It is similar to the TLAC standard

³ State aid to European banks: returning to viability, European Commission, February 2015 ([Link](#))

⁴ [Link](#)

developed under the aegis of the FSB for Global Systemically Important Banks (G-SIBs), referred to as G-SIIs in the EU.

- 20 **The Commission Delegated Regulation (DR) 2016/1450 of 23 May 2016 further specifies the calibration and composition of MREL.** It was adopted in accordance with article 45(2) of the BRRD, and based on the work conducted by the European Banking Authority (EBA). The DR is directly applicable and enforceable, thereby ensuring a high degree of harmonization in the determination of MREL throughout the EU. MREL is split into two components: i) a default LAA⁵, representing the quantum of losses an institution or group should be capable of absorbing; and ii) a RCA, defined as the amount necessary to implement a bank's resolution strategy, e.g. an amount necessary for the bank to continue to comply with the authorization requirements and to carry out its activities, while sustaining market confidence through an additional amount based on the CBR.
- 21 **The DR also introduces room for adjustments in order to tailor default amounts to bank-specific characteristics.** As such, the possibilities for adjusting the default LAA upwards or downwards are closely related to supervisory stress tests, resolvability assessment and the Supervisory Review and Evaluation Process (SREP). The DR also foresees downward adjustments to the RCA based on the preferred resolution strategy, the bank's business model, funding and risk profiles as well as its resolvability assessment. Also, the DR provides for peer group comparisons, specifically when setting the market confidence amount. This is to ensure that the capital position of an institution after resolution would be appropriate in comparison with the capital position of peer institutions. Finally, additional adjustments are possible to account for the contributions from DGS, a bank's size and systemic risk and the exclusions of liability from bail-in.
- 22 **At a global level, the FSB published the TLAC Term Sheet in November 2015.** Like MREL, the TLAC standard requires banks to hold a sufficient amount of loss absorbing (bail-inable) liabilities to ensure credible and successful resolution. However, it only applies to G-SIIs and is set as a Pillar 1 requirement at a fixed amount of minimum 16 percent of RWAs as of January 2019 and 18 percent as of January 2022 (or 6 percent and 6.75 percent of the leverage ratio exposure, respectively). The TLAC term sheet also allows resolution authorities to apply additional firm-specific requirements (i.e. a Pillar 2 component above the common minimum TLAC) if they determine that this is necessary and appropriate to implement an orderly resolution, minimise the impact on financial stability, ensure the continuity of critical functions or avoid exposing public funds to loss with a high degree of confidence.
- 23 **Several international regulatory developments are also relevant, to the extent they will indirectly impact TLAC and MREL.** Indeed, the FSB continues to provide

⁵ The default LAA is defined as the higher of: (i) the sum of a bank's Pillar 1 own funds requirement (art. 92 of the CRR); any Pillar 2 requirement (art. 104(1) of the CRD) and any applicable combined buffer requirement (art. 128(6) of the CRD); (ii) the amount necessary to comply with the bank's Basel 1 floor (art. 500 of the CRR); or (iii) the amount required by any applicable leverage ratio.

guidance on the implementation of the TLAC standard and published a consultation paper on internal TLAC on 16 December 2016. Similarly, the Basel Committee on Banking Supervision (BCBS) recently adopted rules on the deduction of TLAC-eligible instruments and will shortly set new standards for disclosure and reporting of TLAC compliance. The BCBS remains focused on the post-crisis agenda with imminent reforms in respect of risk-modelling of RWAs for standard and advanced approaches, and additional buffers for leverage requirements for G-SIIs. As MREL and TLAC are closely related to both risk-weighted and non-risk-weighted exposures, changes in these areas may have a commensurate effect on MREL.

- 24 **In the EU, the regulatory environment continues to evolve, with the ongoing revision of the BRRD.** Article 45 of the BRRD required the EBA to submit a report on the appropriateness of certain aspects of MREL (*C.f.* Box 1). Taking this assessment into account, the EC put forward a legislative proposal on necessary revisions to MREL on 23 November 2016. The proposal included the introduction of a common minimum requirement for G-SIIs, effectively transposing the TLAC standard into EU law.

Box 1: The EBA report on MREL

EBA released its final report on the implementation and design of the MREL framework⁶ on 14 December 2016. This report was sent to the EC in accordance with the mandate contained in article 45 of the BRRD. The conclusions of the report and the EBA's earlier underlying work contributed to the overall design of the EC legislative proposal on TLAC and MREL, published on 23 November 2016.

The report contains 12 recommendations addressing policy as well as implementation issues, complemented by impact assessments, in particular:

- **Stacking order:** the report addresses implications of breach of the MREL requirement and the interplay with the maximum distributable amount (MDA) framework;
- **Subordination:** the report recommends a mandatory level of subordination covering G-SIIs and O-SIIs, with specific conditions;
- **Internal MREL:** the report recommends i) revising the current BRRD to allow the determination of MREL for entities within banking groups; ii) limiting the application of internal TLAC to subsidiaries of foreign G-SIIs by treating the EU as a single jurisdiction; and iii) considering alternative sources of internal loss-absorbing capacity such as collateralized guarantees. In connection with this last recommendation, the EBA report proposes to introduce a review clause on the possible use of non-collateralized guarantees. The EBA underlines that further work is needed to correctly assess the relevance of guarantees, as an alternative to the repositioning of loss-absorbing capacity for internal MREL purposes;
- **Reporting and disclosure:** the report proposes the development of a uniform reporting framework for institutions to be delivered to resolution authorities at the EU level, building upon existing data requests. The EBA further recommends that credit institutions in the EU should be required to disclose the quantum and composition of their stack of MREL-eligible liabilities, as well as information on the relevant creditor hierarchy.

⁶ [Link](#)

SRB APPROACH TO MREL IN 2016

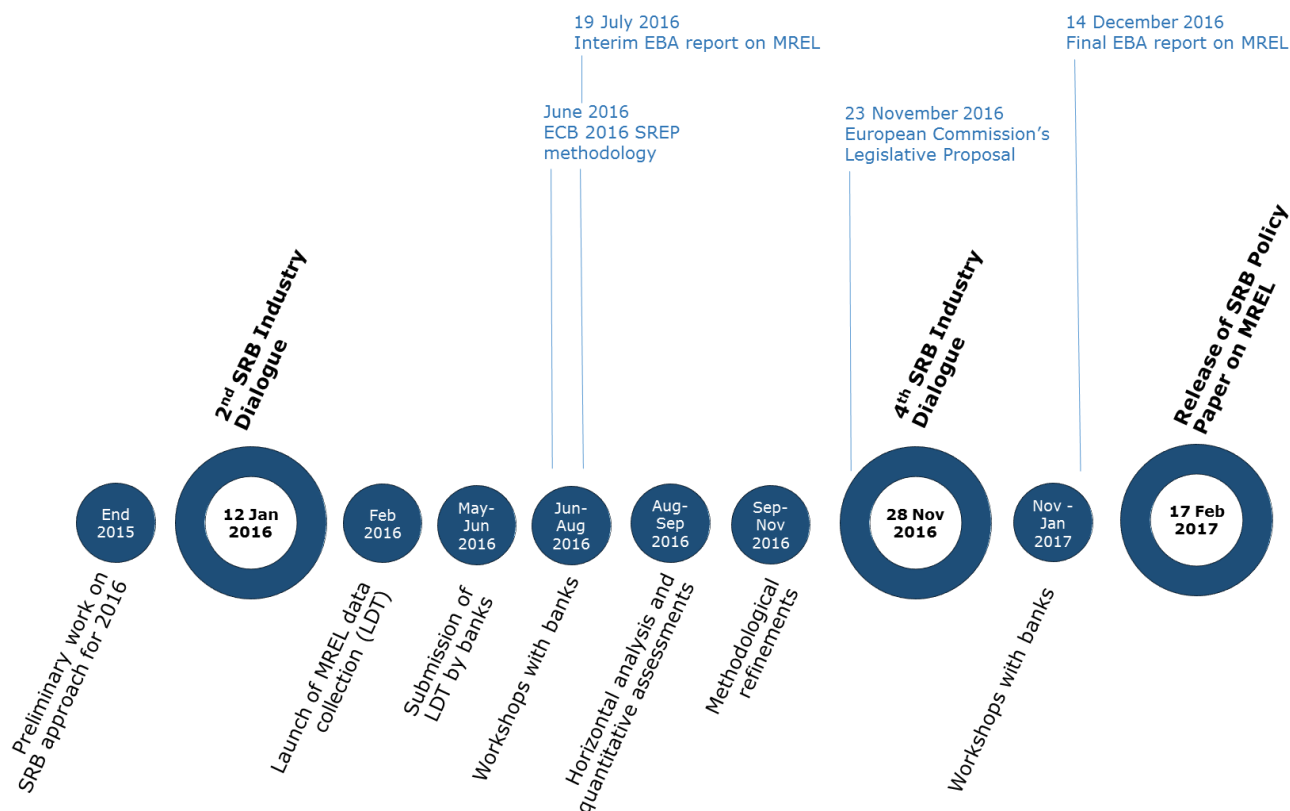
A- THE MREL JOURNEY

- 25 **The SRB is committed to implementing MREL throughout the BU, in accordance with the relevant legislation.** Article 12 of the SRM-R requires the SRB to determine MREL for entities and groups that are under the direct supervision of the European Central Bank (ECB), as well as other BU cross-border groups. NRAs within the BU are responsible for MREL on less significant institutions (LSIs), in line with guidance provided by the SRB.
- 26 **Developing a common methodology represents a considerable challenge given the wide diversity of banking groups in participating Member States and the evolving regulatory environment for MREL.** Indeed, current rules were only clarified in May 2016, when the EC adopted its DR. Similarly, the adoption of the recent legislative proposal on MREL will change the future framework, amending the BRRD and impacting MREL calculations. However, this evolving regulatory landscape and lengthy legislative process should not prevent the SRB from developing and implementing effective loss-absorbing mechanisms.
- 27 **Therefore, the SRB adopted a preliminary approach towards informative MREL targets in 2016.** The SRB previously noted that there would not be a final MREL methodology available for the BU in 2016. As a result, the SRB decided to only calculate informative MREL levels for 2016, taking into account the approach adopted by other EU resolution authorities outside the BU. These informative MREL levels were non-binding, non-enforceable and non-challengeable. They aimed to help banks to prepare for future targets and gradually adapt their structure and funding plans, where necessary.
- 28 **The SRB started engaging with the industry in the first quarter of 2016.** The SRB explained at an Industry Dialogue⁷ in January 2016 the main milestones and core principles of its approach. In February, in consultation with banking groups, it engaged in an MREL data collection exercise with submission dates from banks in May and June (C.f. Box 2). After processing the data and undertaking horizontal quality and consistency checks, and after incorporating the new draft ECB SREP figures in September 2016, the SRB fine-tuned its initial approach. The SRB and NRAs facilitated workshops with banks to explain the methodology in detail and to seek feedback. The SRB communicated its final MREL approach for 2016 through another Industry Dialogue⁸ on 28 November 2016.

⁷ [Link](#)

⁸ [Link](#)

Figure 1: The MREL journey in 2016 - Overview of the timeline



Box 2: MREL data collection within the SRM

In 2016, the SRB developed a dedicated data template (“Liability Data Template”, LDT).

The LDT allows resolution authorities to define MREL targets, identify MREL-eligible liabilities and more generally provides key information on the quantum and the composition of bail-in-able instruments, as well as information on final liability holders. The LDT was in an Excel format.

The LDT has been designed in cooperation with the industry and was requested to be completed on a best efforts basis. The LDT was required both at consolidated and solo level for all legal entities incorporated in the EU that fulfil at least one of these three conditions: (i) they take deposits; (ii) they trade derivatives; or (iii) they issue securities.

In 2017, the SRB is migrating the template into XBRL technology. While maintaining the possibility to use Excel solutions in the short term, the objective is to further improve reporting quality, while the SRB will remain closely involved in EU initiatives to develop harmonized reporting standards, building upon existing solutions.

B- INFORMATIVE MREL TARGETS

Overview of the mechanical approach in 2016

- 29 **Based on the DR, the SRB adopted a “mechanical” approach to calculating MREL in 2016 and decided not to apply adjustments to the default amounts, with one exception related to the MCC.** The SRB’s preliminary MREL approach was based on a default LAA and a default RCA, including an additional MCC, and did not take into account the results of individual assessments carried out in respect of bank-specific features, such as the resolution strategy, its business and risk profiles or any identified impediments to resolvability (*C.f.* Figure 2).
- 30 **Informative MREL targets were defined at consolidated level only.** As a first step, the SRB calculated consolidated MREL targets at the level of the EU consolidating parent. Pending further policy developments in respect of internal MREL, requirements at solo level were not addressed in the preliminary approach for 2016.
- 31 **In addition to the formula as set out in the DR, the SRB took into account an eight percent benchmark.** MREL should be set at a level sufficiently prudent to allow access, if necessary, to financing arrangements like the Single Resolution Fund (SRF) in the BU. To ensure that bank resolution does not depend on the provision of public financial support and that the Union system of resolution financing arrangements contributes to financial stability, the SRB took the view that MREL of at least eight percent of TLOF should generally be required for major banking groups within the BU (*C.f.* Box 3).

Box 3: The eight percent benchmark

Scope of consolidation. In 2016, the total balance sheet was assessed on the basis of the prudential scope of consolidation, which is also used for the prudential calculation reported in FINREP and COREP. This was consistent with the guidance on the LDT, which requested banks to fill in the template on the basis of the prudential scope of consolidation.

* * *

Treatment of derivatives. Derivative exposures were offset on the basis of the prudential framework, as a proxy for contractual set-off, which would apply in case of bail-in of derivatives, and to be consistent with the calculation of prudential own funds.

* * *

Exemptions. The eight percent threshold is seen as a benchmark likely to trigger increased scrutiny of the bank if it becomes a binding constraint. Relevant measures may be taken on a case-by-case basis considering the calibration of the MREL target. The SRB may consider exceptions to the eight percent benchmark, such as in the case of promotional banks which are fully owned by national or regional governments in order to promote public sector development goals, especially when bail-in is not the preferred resolution tool. In such cases, the low RWA density of a bank may cause the strict application of the MREL methodology to result in an over-reliance on balance sheet size, without reflecting the specificities of the business model should the bank be put in resolution.



- 32 **Informative MREL targets were calculated for the vast majority of the banking groups, on the basis of an assumed SPE resolution strategy with bail-in.** The SRB approach did not consider yet other resolution tools, such as transfer strategies. The SRB is currently developing a specific MREL approach for banks with an MPE resolution strategy.
- 33 **The SRB did not adjust informative MREL targets for DGS contributions or for ex ante exclusions from bail-in.** Although the DR allows the SRB to adjust the overall target to take into account the potential contribution of a DGS to resolution financing, the SRB did not make use of this option. Furthermore, the SRB did not calibrate informative MREL targets on the basis of exclusion of certain liabilities from bail-in. Particular attention will be paid to these issues, together with the characteristics of MREL-eligible instruments at a later stage when the SRB adjusts a bank's MREL according to the resolution strategy and its risk profile.

Figure 2: SRB MREL approach for 2016

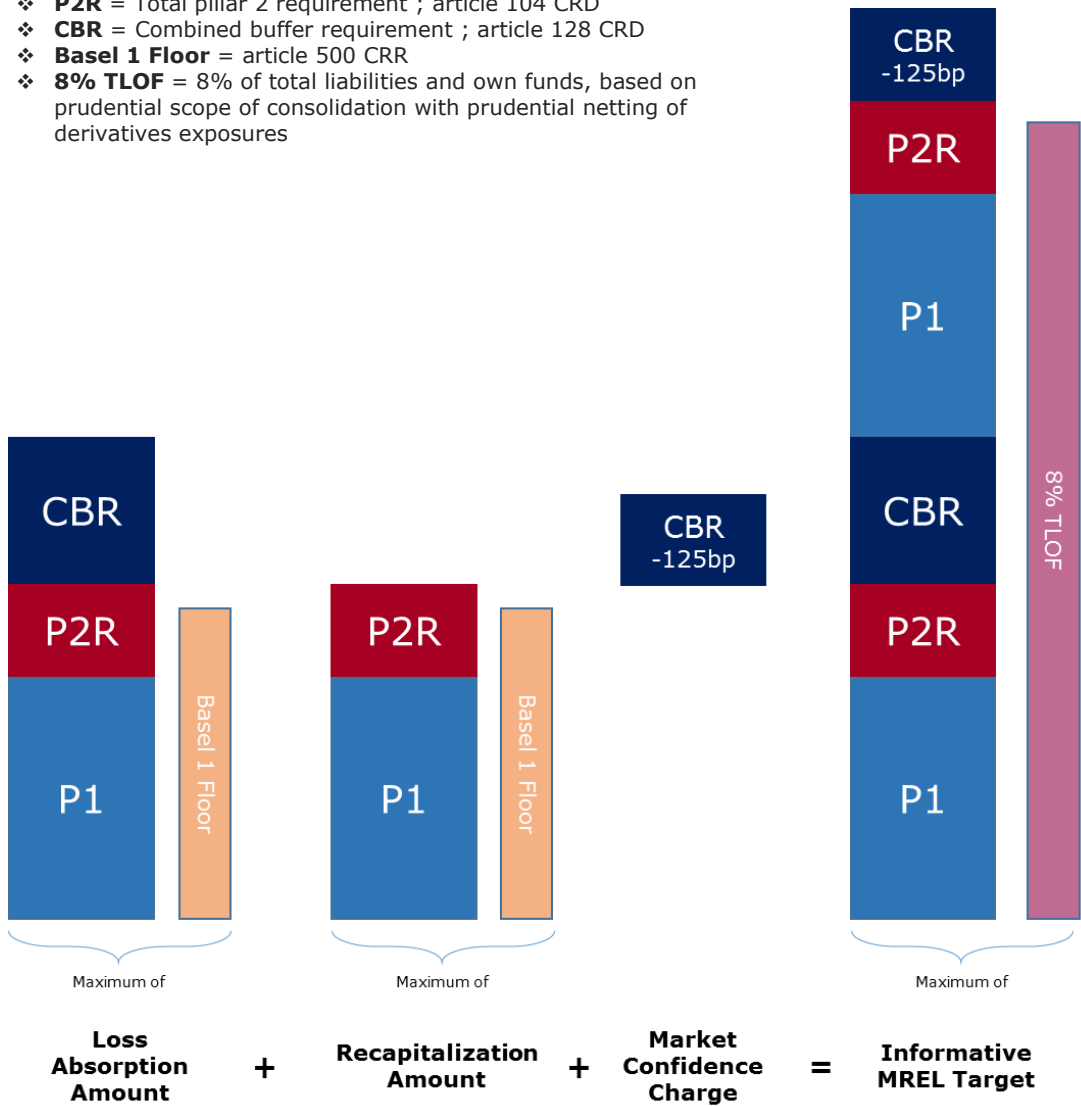
**Informative MREL Target = Loss Absorption Amount
+ Recapitalization Amount
+ Market Confidence Charge**

**Informative MREL Target = Max(P1 + P2R + CBR ; Basel 1 floor)
+ Max(P1 + P2R ; Basel 1 floor)
+ CBR - 125bp**

With the informative MREL target not being lower than 8% of total liabilities and own funds.

Legend

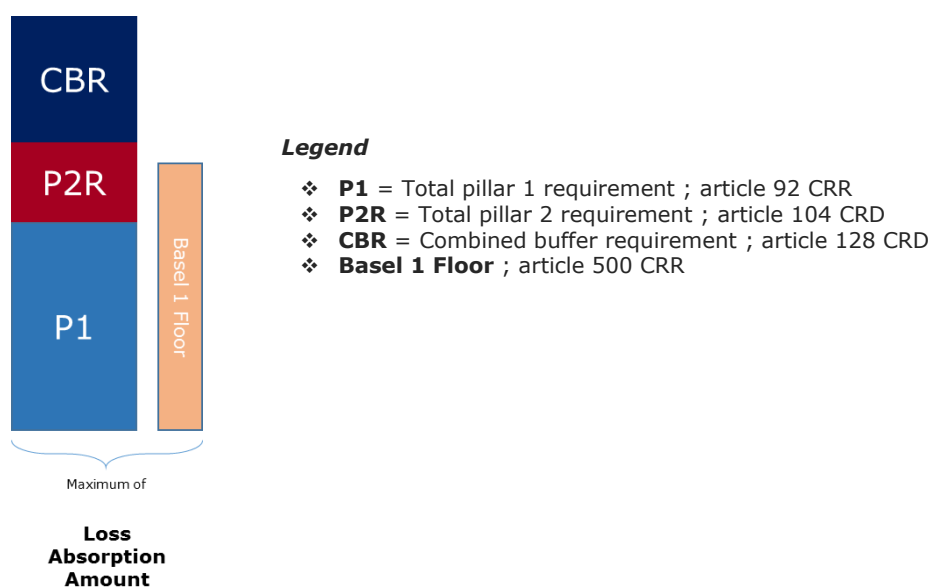
- ❖ **P1** = Total pillar 1 requirement ; article 92 CRR
- ❖ **P2R** = Total pillar 2 requirement ; article 104 CRD
- ❖ **CBR** = Combined buffer requirement ; article 128 CRD
- ❖ **Basel 1 Floor** = article 500 CRR
- ❖ **8% TLOF** = 8% of total liabilities and own funds, based on prudential scope of consolidation with prudential netting of derivatives exposures



The default loss absorption amount was used for 2016

- 34 **The SRB set the LAA at the default level.** Based on the DR, the LAA consists of the higher of: (i) the sum of a bank's minimum capital requirement (Pillar 1), its Pillar 2 requirement excluding Pillar 2 guidance, and its fully-loaded combined buffer requirement (CBR); or (ii) the amount required to meet the Basel 1 floor. The SRB did not apply any upward or downward adjustments to the LAA (*C.f.* Box 4).

Figure 3: SRB approach for the Loss Absorption Amount in 2016



- 35 **The SRB did not consider the leverage ratio in the calculations of the informative target.** The leverage ratio exposure was not included in the LAA since the precise requirement is still uncertain pending the finalization of the EU legislative process and international work at BCBS, in particular with respect to leverage buffer for G-SIIs. Once introduced in the EU legislation as a compulsory ratio, the SRB will revisit its stance and consider it as one of the variables for setting the LAA.

Box 4: Adjusting the Loss Absorption Amount

The DR allows resolution authorities to set a LAA different from the default amount (article 1(5) of the Delegated Regulation).

Conditions for a higher LAA. The DR foresees upward adjustments where: 1a) the need to absorb losses in resolution is not fully reflected in the default LAA, taking into account an institution's business model, funding model, and risk profile; or 1b) it is necessary to reduce or remove an impediment to resolvability or absorb losses on holdings of MREL instruments issued by other group entities.

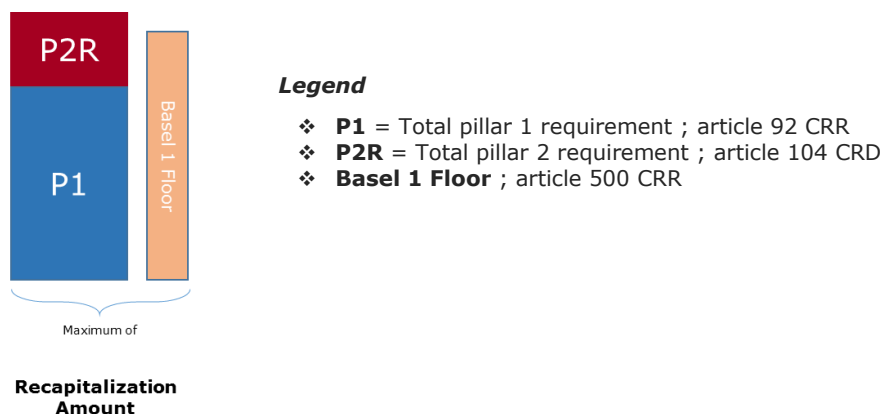
Conditions for a lower LAA. The DR foresees downward adjustments to the extent that: 2a) additional own funds requirements, which have been determined on the basis of stress tests or to cover macro-prudential risks, are assessed not to be required to ensure losses can be absorbed in resolution; or 2b) part of the combined buffer requirement is assessed by the resolution authority not to be required to ensure losses can be absorbed in resolution.

SRB interpretation. To determine the informative MREL target in 2016, the SRB used the default LAA with the fully-loaded CBR as per article 1(4) of the DR, with no adjustment given in light of the new SREP methodology that excludes losses in stress scenario from the Pillar 2 requirement, but retains as Pillar 2 all risks that are not captured in Pillar 1. Setting a higher LAA due to impediments to resolvability can only be determined later on, once impediments have been identified.

The recapitalization amount did not consider bank-specific adjustments

- 36 **For 2016, the SRB decided to set default RCA levels, without addressing the bespoke adjustments contemplated in the DR.** The RCA represents the capital levels required for a bank to maintain its activity after resolution and to comply with the conditions for ongoing authorization. It consists of the higher of: (i) the sum of a bank's minimum capital requirement (Pillar 1) and any Pillar 2 requirement, excluding Pillar 2 guidance; or (ii) the amount to meet the Basel 1 floor. Similarly to the LAA, the leverage ratio is not factored into the calculations of the RCA by the SRB for the moment.
- 37 **The SRB decided not to apply adjustments of the RCA in 2016** (C.f. Box 5). Indeed, the mechanical approach applies to all banks and will be refined in 2017 in light of the empirical evidence gained during future resolution planning conducted by the SRB.

Figure 4: SRB approach for the Recapitalization Amount in 2016



Box 5: Adjusting the Recapitalization Amount

The DR allows resolution authorities to set a RCA different from the default amount.

Conditions for a lower RCA.

- 1- *Resolution strategies.* Articles 2 and 4 of the DR provide for an individual assessment of a bank's preferred resolution strategy and characteristics when calibrating the recapitalization amount. In particular, where the resolvability assessment concludes that liquidation of the institution under normal insolvency proceedings is feasible and credible, the recapitalization amount shall be set at zero.
- 2- *Changes to capital needs after resolution.* Article 2(3) of the DR states that when estimating an institution's regulatory capital needs after implementation of the preferred resolution strategy, the resolution authority shall use the most recent reported values for the relevant total risk exposure amount, unless all the following factors apply: (i) the resolution plan identifies, explains and quantifies any change in regulatory capital needs (e.g. if specific resolution measures have an impact in terms of RWA reduction) as a result of resolution action; and (ii) the change is considered in the resolvability assessment to be both feasible and credible without adversely affecting the provision of critical functions and without recourse to extraordinary financial support, other than contributions from resolution financing arrangements.
- 3- *Requirements for authorization post-resolution.* Article 2(8) of the DR allows the resolution authority to determine, in consultation with the competent authority, that it would be feasible and credible for all or part of any additional own funds requirement or buffer requirements currently applicable to the entity not to apply after implementation of the resolution strategy.

SRB interpretation. Informative MREL targets under the "mechanical" approach in 2016 did not contain any adjustment based on resolution strategy or recovery measures.

- 1- The preferred resolution strategy may not foresee the recapitalization of some of the group's subsidiaries. Nonetheless, caveats apply in 2016: the credibility and feasibility of allowing subsidiaries to enter insolvency without negatively affecting the provision of the group's critical functions needs to be demonstrated, which is not the case at this early stage of resolution planning. Similarly, the preferred resolution strategy may contemplate a separation of the bank and not require a recapitalization for those assets and liabilities that would be left behind. The separation needs to be credible and feasible and the perimeter of assets and liabilities needs to be clearly identified in the resolution plan,

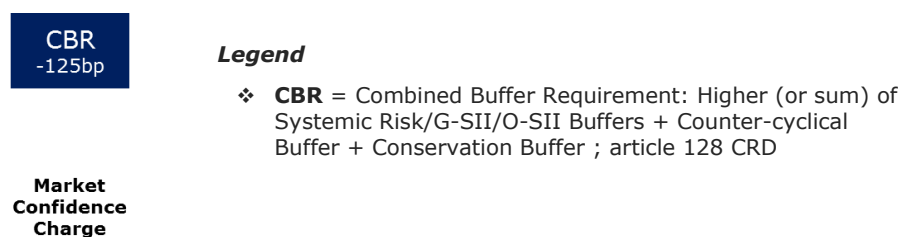
which is not the case at the infancy of resolution planning. Furthermore, complex banking structures might warrant upwards adjustments.

- 2- With regard to the changes to capital needs after resolution, the SRB will further analyse the impact of de-risking/de-leveraging measures in recovery and resolution on the level of RWAs. The SRB will follow the development of the legal framework on this matter, in order to set MREL targets in line with applicable regulations.
- 3- The SRB did not make bespoke adjustments in 2016 but will identify in consultation with the ECB where it may be feasible and credible for all or part of the CBR currently applicable to the entity not to apply after the implementation of the resolution strategy.

The SRB requested a market confidence buffer

- 38 **The SRB decided to define an intermediate target for the MCC in 2016.** The MCC represents the amount necessary to ensure market participants have confidence in the resolved bank. As such, banks may, after the application of the bail-in tool, need to be able to absorb additional losses stemming from possible reorganization measures without immediately failing to meet minimum capital requirements again. In the context of varied central bank arrangements not permitting harmonized expectations in respect of back-stop mechanisms, the SRB set the level of the MCC in 2016 at the CBR less 125 basis points, taking into account the approach adopted by other resolution authorities in the EU.

Figure 5: SRB approach for the Market Confidence Charge in 2016



- 39 **In 2016, no further adjustments were made to the MCC.** The SRB will define a methodology to assess peer-group comparisons contemplated by the DR (*C.f.* Box 6).

Box 6: Adjusting the Market Confidence Charge

The DR requires resolution authorities to include an additional amount necessary to maintain sufficient market confidence after resolution (article 2(7) of the DR), but gives resolution authorities a choice in setting this additional amount (article 2(8) of the DR).

- The default amount shall be equal to the CBR after the application of resolution tools;
- The resolution authority may set a lower amount, if the resolution authority determines that a lower amount would be sufficient to sustain market confidence and ensure both the continued provision of critical economic functions by the institution and the access to funding without recourse to extraordinary financial support;
- The resolution authority may set a higher amount, if it determines that a higher amount would be necessary to sustain market confidence;
- Setting such amount shall take into account an appropriate comparison with the current capital position of peer institutions.

SRB interpretation. Pending the finalization of a methodology to assess peer-group comparisons and the implementation of the resolution strategies, the SRB decided not to apply supplementary adjustments to the MCC.

As such, the SRB acknowledged that the DR clearly states that all components of the CBR should be computed when defining the MCC. However, article 2(8) of the DR provides some flexibility since resolution authorities may determine that it would be feasible and credible for all or part of any additional own funds requirement or buffer requirements currently applicable to the entity not to apply after implementation of the strategy. As a first step, the SRB considered that, for 2016 informative targets, an amount corresponding to the CBR reduced by 125 basis points would be sufficient.

C- ELIGIBLE INSTRUMENTS

- 40 As part of its resolvability assessment, the SRB will evaluate whether banks meet their MREL targets or not (i.e. whether there is a shortfall). In doing so, it will assess which instruments are eligible for MREL purposes. In 2016, the SRB took a preliminary approach to eligibility based on the criteria set out in the BRRD. This approach will be fine-tuned in 2017 and beyond taking into account the EC legislative proposal, which revises *inter alia* CRR and further harmonizes eligibility criteria.

Subordination was requested for G-SIIs

- 41 **For the 2016 informative targets, G-SIIs should meet, at a minimum, a subordination target equal to 13.5 percent of RWAs plus their CBR.** For G-SIIs, the SRB assumed that the TLAC requirement for subordination will be transposed as a binding minimum standard into EU law, including exemptions, whose application has been established. Alternatively, the TLAC requirement could be met on a case-by-case basis by own funds and senior debt, if the amount of TLAC-excluded liabilities that rank *pari passu* or junior to TLAC-eligible liabilities does not exceed 5 percent of all eligible external TLAC.

- 42 **For other systemic banks, the SRB considers sufficient subordinated instruments to be essential for implementing preferred resolution strategies.** In that respect, the TLAC reference is useful, especially for the largest of Other Systemically Important Institutions (O-SIIs). The SRB has not yet developed a detailed methodology for determining the proportion of MREL (in excess of the own funds requirement) that should be subordinated. In order to do so, the SRB will develop its policy on subordination based on preferred resolution strategies, NCWO risks and the resolvability of banks, as well as taking into account the outcome of the EU legislative process in respect of the EC's proposal on TLAC implementation.

Structured notes and SPV-issued liabilities were excluded from informative MREL

- 43 **The SRB took a cautious approach and excluded all debt obligations identified as structured notes from the calculation of MREL-eligible liabilities as a starting point.** Liabilities arising from a derivative are excluded from MREL under the BRRD, as well as from the TLAC standard. However, the SRB notes a limited range of instruments exists which may be MREL eligible. If a banking group is able to demonstrate that some part of its structured notes do not include liabilities arising from a derivative, such liabilities may be considered to be MREL eligible following a case-by-case analysis and subject to the outcome of the legislative process in respect of the EC's recent proposal on MREL.
- 44 **The SRB started to conduct deeper analysis of liabilities issued by SPVs established outside of the EU and SPVs established within the EU but outside of the scope of the BRRD.** If a SPV is established outside the EU, its liabilities cannot be counted towards MREL at the consolidated level of the EU parent, since its liabilities are beyond the scope of the powers of EU resolution authorities. If a SPV is established in the EU, the SPV may fall within the scope of the BRRD, depending on its qualification as financial institution under the Capital Requirement Regulation (CRR). If not, its liabilities are similarly beyond the scope of resolution authorities' powers. Should a SPV fall within the scope of the BRRD, all the other MREL eligibility criteria must also be met; in particular, the liabilities must not arise from a derivative and must not be guaranteed by another institution within the group (unless the guarantee itself takes into account the residual amount after bail-in, which will be subject to a case-by-case assessment).
- 45 **In the same vein, the SRB excluded in most cases liabilities governed by the laws of a country outside of the EU from the calculation of available MREL.** When liabilities are not governed by EU law, resolution authorities face the risk that the courts of the country whose law governs the liabilities may not recognise the bail-in or transfer order of an EU resolution authority. Hence, the BRRD sets two conditions: i) article 55 of the BRRD requires institutions to introduce contractual bail-in clauses in respect of liabilities that are within the scope of the bail-in tool, but are governed by the laws of a third country; ii) the bank must also demonstrate the effectiveness of a contractual bail-in clause under the third country law, e.g. through an independent legal opinion.

- 46 **Liabilities issued by institutions incorporated outside the EU were also not recognized as MREL eligible.** Eligible liabilities must be issued by an entity that is incorporated within the EU - otherwise resolution authorities' powers could not be applied. As an exception, for the 2016 informative consolidated MREL target, minority interests in subsidiaries (i.e. own funds instruments issued to external investors) can be included to the extent that they are recognised in the own funds of the EU parent, if the foreign subsidiary is part of the resolution group of the EU parent (i.e. if the resolution strategy foresees that the foreign subsidiary would be resolved through the EU parent).

Non-covered and non-preferred term deposits, whose term was greater than one year, were considered MREL-eligible liabilities unless proven otherwise

- 47 **The SRB included uninsured and non-preferred term deposits in its 2016 computations.** The BRRD foresees that all deposits that are not covered deposits are bail-in-able and could be subject to loss. The EBA provided additional guidance⁹ on eligibility criteria, stating that "a deposit that is deposited for at least a year's period but which confers upon the owner a right to early reimbursement with less than one year's notice shall not be included in the amount of own funds and eligible liabilities meeting MREL". In addition, experience has shown that applying the bail-in tool to any form of deposits may raise financial stability concerns. Nevertheless, for the 2016 informative targets, the SRB kept a simple approach which will have to be revisited in coming years.

Liabilities held by retail investors were considered MREL eligible

- 48 **The SRB will be required to bail-in retail investors in line with their ranking in the applicable creditor hierarchy, other than in exceptional circumstances.** The SRB cannot exclude instruments from MREL for the sole reason that they are held by retail investors should they otherwise meet the requirements for MREL. There is no legal basis for resolution authorities to exclude *ex ante* and uniformly eligible liabilities held by natural persons or SMEs from MREL or from bail-in. European legislation includes many safeguards to ensure financial products are sold to suitable investors only. The implementation and the supervision of such rules is under the responsibility of Member States' market authorities; therefore any possible failure to comply with investor protection rules is not an argument to exclude these liabilities from the computation of informative MREL targets or finally bail-in.

- 49 **However, holdings of subordinated or senior instruments by retail customers could prove to be an impediment to resolution due to the consequences arising from the application of the bail-in tool.** The SRB is of the view that large holdings of liabilities sold to retail investors make banks difficult to resolve for various reasons, including: i) the potential loss of a bank's customer base and the risk of withdrawals, as

⁹ EBA Q&A 2015_2267: [Link](#)



well as ii) potential litigation brought by retail investors upon or after resolution, which might endanger the bank's future viability). In this context, the difficulties associated with the issuance of MREL-eligible instruments to retail investors is connected to the broader issue of the quality of MREL instruments. The SRB will further assess significance of retail investors in different Member States and develop potential measures to address the issue, for instance, by means of higher MREL, subordination requirements or requesting adjustments to banks' funding strategies, should the situation be considered an impediment to a bank's resolution.

Cross-holdings of MREL-eligible instruments were considered MREL eligible

- 50 **In 2016, the SRB did not exclude holdings of MREL-eligible instruments issued by external institutions.** In this context, MREL holdings held by other banks are currently counted as MREL for the issuer. The SRB notes that the TLAC standard provides for the deduction of cross-holdings of eligible instruments for G-SIIs.

Going forward: next steps for 2017 and beyond

- 51 **The determination of MREL will continue to evolve in 2017 and beyond.** The SRB will further develop its MREL methodology in order to achieve a consistent framework, applicable to all banking groups in the BU. Several aspects will be addressed in the SRB's finalised MREL methodology, taking into account the evolving EU regulatory framework.
- 52 **The SRB will base its policy statements on existing legislation and will closely follow the outcome of the negotiations in respect of the EC's legislative package.** Any development at EU level may influence the methodology defined in the BU. The work plan for refining the SRB MREL methodology will follow the key principles highlighted in 2016, by expanding on each of the priorities identified so far.

MREL targets will become bank specific

- 53 **The SRB is committed to developing MREL at material entity level within major banking groups and to start addressing the quality and location of MREL.** As a first step, the SRB intends to set binding MREL targets at consolidated level (or appropriate sub-consolidated level according to the resolution strategy) for major banking groups under its remit in 2017, followed by determining targets at solo level for legal entities subject to BRRD late 2017/2018.
- 54 **Future MREL targets will consider bank-specific features, departing from the default targets used in 2016.** In this context, the SRB envisages further work in respect of the impact of resolution strategies developed during the 2016 resolution planning exercise, resulting in the tailoring of MREL to bank-specific characteristics, including risk profile and business models, before and after resolution. Similarly, the SRB will analyse the impact of recovery actions, *ex ante* exclusions from bail-in and impediments to resolvability on the MREL needs of each banking group. The SRB does not currently pre-empt any decision as to the direction nor the magnitude of adjustments which may be made. Furthermore, building on experience gained during the resolution planning phase, the SRB will conduct peer group analyses, with a particular focus on the amounts needed to ensure market confidence after resolution.

Quality of MREL-eligible instruments will be further assessed

- 55 **The SRB will define its approach to subordination for banks under its remit.** The link to a bank's resolution strategy and the need to ensure effective resolution actions should a resolution scheme be adopted will be duly taken into consideration. The SRB will also assess the necessity of subordination to adhere with the NCWO principle, with the aim of preserving financial stability while ensuring resolution objectives are met.

- 56 **In parallel, requirements in respect of the quality of MREL-eligible instruments will be significantly enhanced.** The SRB will conduct a thorough assessment of the eligibility criteria for relevant instruments, beyond subordination. Further analysis is expected in respect of structured notes, SPV issuance, liabilities governed by third country laws and term deposits. Finally, a policy stance with respect to deductions of cross-holdings of MREL-eligible instruments will be defined.

Banking groups will be subject to an internal MREL framework

- 57 **A major step in the development of the SRB's methodology for banking groups will be the establishment of an operational framework for internal MREL.** The location of MREL, as well as its calibration and the form of loss-absorbing capacity to be used to meet the requirement, will be analysed in order to promote an efficient and effective mechanism for the resolution of banking groups. The concepts of resolution entities and resolution groups, as identified by the preferred resolution strategy, will be considered. Key considerations will also be given to the need for internal TLAC for subsidiaries of foreign G-SIIs operating in the BU.
- 58 **Similarly, the SRB will endeavour to establish a robust methodology for determining MREL for banking groups subject to an MPE resolution strategy.** The specific internal structure of relevant banking groups will be analysed further to create a framework suited to the business model of the group and the resolution objectives.

Binding requirements will be set using adequate transition periods

- 59 **Setting binding MREL targets at consolidated level, the SRB will define appropriate transition periods.** A transition period is necessary to ensure the credibility of the resolution framework, allowing time for institutions to build up the necessary loss-absorption capacity. The SRB will closely assess the impact of the proposed methodology on the markets, both at BU and at participating Member State level, addressing not only issues related to market capacity but also to market access. Furthermore, the SRB will also analyse the possibility of granting transition periods in respect of the quantum of MREL instruments required but also the quality, for instance with respect to subordination.
- 60 **During the transition period, once defined, the SRB does not intend to publish its individual decisions on MREL targets.** Rather, it may require banks to disclose the composition of their MREL eligible instruments.



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