



Minimum Requirement for Own Funds and Eligible Liabilities (MREL)

2018 SRB Policy for the first wave of resolution plans

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MREL policy – first wave of resolution plans

Disclaimer: The SRB MREL policy is subject to further revisions, including as a result of changes in the applicable European Union (EU) legislation. This public document aims to make the public in general, and institutions in particular, aware of the SRB MREL policy as well as the process currently being followed to determine MREL targets in the SRB 2018 resolution planning cycle. The SRB MREL policy represents a common approach to ensure consistency and a level playing field within the Banking Union, and takes into account where necessary any bank-specific features. The SRB may deviate from the content of this document if it considers it necessary and in line with bank-specific features and the applicable legislative framework.

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ABBREVIATIONS

BRRD	Bank Recovery and Resolution Directive
CBR	combined buffer requirement
DGS	deposit guarantee scheme
DR	Commission Delegated Regulation
EU	European Union
FSB	Financial Stability Board
G-SII	Global Systemically Important Institution
LAA	loss-absorbing amount
MCC	market confidence charge
MPE	multiple points of entry
MREL	minimum requirement for own funds and eligible liabilities
NCWO	no creditor worse off
P1	Pillar 1 requirement
P2R	Pillar 2 requirement
RC	resolution college
RCA	recapitalisation amount
RWA	risk-weighted assets
SRB	Single Resolution Board
SREP	supervisory review and evaluation process
TLAC	total loss-absorbing capacity

INTRODUCTION

- 1 The minimum requirement for own funds and eligible liabilities (MREL) corresponds to the minimum amount of loss-absorbing capacity that is also covered by the international standard of total loss-absorbing capacity (TLAC) developed by the Financial Stability Board.** It was enacted in the Bank Recovery and Resolution Directive (BRRD) in May 2014, for all banks, and the Single Resolution Board (SRB) is committed to implementing and enforcing the applicable legal framework, including by setting MREL targets for the banking groups under its remit.
- 2 The SRB foresees a transitional two-step approach to the MREL-setting process for the 2018 planning cycle.** For this year, considering the need to address the specificities of the most complex groups with more details, the SRB has split the cycle for resolution planning into two waves. The first started in January 2018 to allow for the banks that did not have binding targets in 2017 to be addressed first based on a MREL policy largely following the 2017 approach published by the SRB on 20 December 2017.
- 3 The present document serves as a point of reference for the determination of SRB decisions on MREL for these banks.** For the most complex banks, all of them having resolution colleges (RCs) ⁽¹⁾ to be organised pursuant to EU legislation, the 2017 planning cycle only closed in early 2018; given that the new planning cycle only started in summer 2018, MREL setting for these groups will be based on an enhanced MREL policy to be published soon.
- 4 This policy statement updates the general MREL approach for 2017, published in December 2017, by adding a few additional features.** First, the MREL policy now caters for all resolution tools, and not only for strategies based on an open-bank bail-in. Second, the MREL policy removes the reference to the Basel I floor in the MREL formula.

⁽¹⁾ In the context of the Banking Union, a banking group is subject to an RC when it operates in two or more Member States, of which one is not part of the Banking Union. An RC, comprising the authorities of the relevant Member States, is therefore established in line with the BRRD to ensure coordination between authorities for cross-border banking groups. If a group operates only in the Banking Union, the SRB is the sole group-level resolution authority and works directly in cooperation with national authorities from participating Member States.

METHODOLOGY

A – TARGETS AND LOCATION

- 5 **The MREL policy builds on the delegated regulation (DR) ⁽²⁾ default formula**, made up of two components: (i) a default loss-absorbing amount (LAA), which reflects the losses that the bank will incur in resolution, and (ii) a recapitalisation amount (RCA), which reflects the capital needed to meet ongoing prudential requirements after resolution. The latter component is complemented by a market confidence charge (MCC), necessary to ensure market confidence post-resolution. MREL targets are based on fully loaded risk weighted assets (RWAs) and fully loaded capital requirements.
- 6 **While the leverage ratio remains excluded from the MREL formula, the Basel I floor has been removed from the MREL requirements.** The leverage ratio is not included in the computation because it remains non-binding under the current legal framework. By contrast, the Basel I floor has been removed from the MREL formula because it is no longer applicable (Article 500 of the Capital Requirements Regulation expired on 31 December 2017).
- 7 **MREL targets will be set using supervisory and resolution reporting data from the previous year.** MREL targets will be set using the final supervisory review and evaluation process (SREP) decisions and Pillar 2 requirements approved in 2017, and based on end-2017 balance sheet data.

The SRB does not adjust the default LAA

- 8 **The SRB uses the default LAA without adjustments.** In accordance with the DR, the SRB considers the default LAA the sum of a bank's minimum capital requirement (Pillar 1 requirement), its Pillar 2 requirement (P2R), and its fully loaded combined buffer requirement (CBR).

$$\text{SRB default LAA} = \text{P1} + \text{P2R} + \text{CBR}$$

The SRB takes bank-specific adjustments into account for the RCA and keeps the MCC unchanged

- 9 **The default RCA remains the starting point for MREL determination.** Under the DR, there are two components of the RCA: the minimum requirement for authorisation (P1 and P2R), and an amount intended to regain market confidence, the MCC. In line with the

⁽²⁾ Commission Delegated Regulation (EU) 2016/1450.



2017 MREL policy, the SRB has decided to set the default MCC at the level of the CBR less 125 basis points.

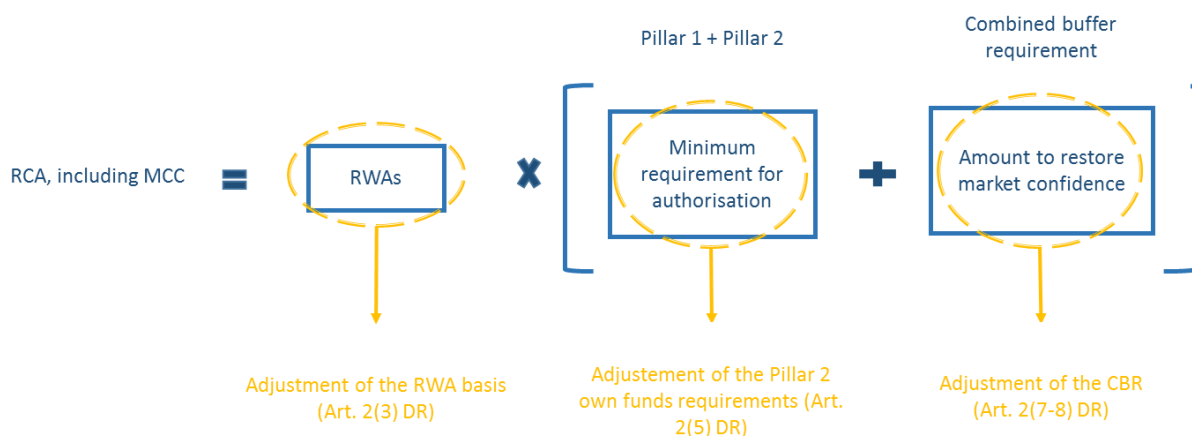
$$\text{SRB default RCA} = \text{P1} + \text{P2R}$$

$$\text{SRB default MCC} = \text{CBR} - 125 \text{ basis points}$$

- 10 **Banking groups for which liquidation is the preferred resolution strategy have no RCA.** Where the preferred strategy at the level of the group is liquidation, MREL will be set at the level of the LAA, with no RCA and no MCC.
- 11 **Bank-specific adjustments are considered on the basis of the DR.** The DR enables resolution authorities to make bank-specific adjustments to three components of the RCA, including the MCC. These adjustments relate to the following (see also Figure 1):
- 1) The RWA basis for the calculation of the RCA and MCC: while the DR makes it clear that the default amounts should be the starting point, resolution authorities may use a different RWA basis from the reported RWA to calculate the RCA and the MCC ⁽³⁾.
 - 2) The Pillar 2 own funds requirements used for the default RCA: these can be adjusted to tailor the amount required to satisfy the applicable capital requirements to comply with the conditions for authorisation after the implementation of the preferred resolution strategy.
 - 3) The level of the CBR used for the default MCC: this can be adjusted to tailor the amount required to maintain sufficient market confidence after resolution.

⁽³⁾ In particular, when the resolution plan identifies, explains and quantifies any change in regulatory capital needs immediately as a result of resolution action, and when this change is considered in the resolvability assessment to be both feasible and credible without adversely affecting the provision of critical functions by the institution and without recourse to extraordinary public financial support.

Figure 1: Bank-specific adjustments under the DR for the RCA, including the MCC



12 **The SRB may allow, on a bank-by-bank basis with due justification, three adjustments to the RWA basis.** These adjustments relate to:

- 1) **The effect of balance sheet depletion:** the failure of a banking group may result in the banking group having a smaller balance sheet directly following resolution, particularly if the failure was due to credit risk losses. The SRB considers that, on a group-by-group basis, a maximum balance sheet depletion of up to 10% of total assets may be used to adjust the RWA basis ⁽⁴⁾.
- 2) **The use of recovery options:** the SRB will consider only those limited recovery options that can be implemented swiftly as a resolution action, assuming that the bank was unable to use them in the early intervention or recovery phase.
- 3) **Restructuring plan divestments and sales:** if actions as formulated in restructuring plans ⁽⁵⁾ are legally binding and time-bound, the SRB may take into account the possible impact on the bank's RWA basis. These plans aim to restore the long-term viability of the bank by achieving sustainable profitability and reducing risk, among other goals. This includes the removal from the balance sheet of riskier assets with associated higher risk weighting through mandatory deleveraging actions embedded in the restructuring plan.

⁽⁴⁾ The SRB assumes that the incurred losses would equal the LAA, and that these losses would reduce the total asset amount of the balance sheet accordingly under the assumption that the risk density of the assets would remain stable post-resolution in comparison with its *ex ante* resolution level.

⁽⁵⁾ For instance, following the receipt of state aid, European Commission-approved restructuring plans.

- 13 **The SRB does not envisage any further adjustments to the default RCA and MCC.**

Other bank-specific adjustments are taken into account for the overall MREL target

- 14 **The SRB maintains the reference to an 8% total liabilities and own funds benchmark.** MREL should be set at a sufficiently prudent level to allow access, if necessary, to financing arrangements such as the Single Resolution Fund. In line with the approach taken in 2017, the SRB will analyse on a case-by-case basis any deviation from this benchmark.

- 15 **In line with the general 2017 MREL policy, the SRB does not envisage any other adjustments to MREL targets for the first wave of resolution plans.** This relates in particular to (i) liabilities mandatorily excluded from bail-in under Article 44(2) of the BRRD, for which preliminary assessments are conducted in resolution plans to assess the possible risk of breaching the no creditor worse off (NCWO) principle when applying the bail-in tool; (ii) liabilities that are likely to be excluded in exceptional circumstances under Article 44(3) of the BRRD and (iii) deposit guarantee scheme (DGS) contributions. The SRB considers that taking into account DGS contributions would not be consistent with the preferred resolution strategy for most of the banking groups under its direct responsibility.

Specificities of multiple points of entry strategies are addressed

- 16 **The SRB MREL policy addresses multiple points of entry (MPE) strategies.** The MREL should be set in a way that is consistent with the distribution of risks across the banking group and located in entities where losses are most likely to arise, following the choice between single point of entry (SPE) and MPE as the selected resolution strategy.

- 17 **MREL for banks with MPE strategies strives to limit contagion risk.** In an MPE strategy, the banking group is resolved through the application of resolution powers to the resolution group where losses materialise. A resolution group comprises a resolution entity (i.e. a point of entry) and its subsidiaries that are intended to be resolved jointly through the upstreaming of losses to the resolution entity. It is essential that a credible and feasible MPE strategy can be executed without undermining the viability and resolvability of other resolution groups. Therefore, contagion risk is minimised where one resolution group within a bank can be resolved without affecting the other resolution groups.

- 18 **The SRB MREL policy identifies the requirement for a consolidated MREL target at the level of the resolution entity, within the MPE group.** MREL targets will be based on the applicable total capital requirement; the applicable total RWA of the resolution group (i.e. excluding the RWA of other resolution groups in the same banking group); and specific adjustments to take into account potential expected LAA stemming from participations in other resolution groups as well as the RCA needs related to residual exposures to those resolution groups following expected loss absorption.

Calibration for transfer strategies

- 19 **In order to use transfer strategies ⁽⁶⁾, resolution plans have to ensure that banks meet high standards in terms of separability and data availability. They also need to analyse the market.** Among other requirements, the planning and operationalisation of transfer strategies have to (i) achieve a certain degree of separability, (ii) ensure a fair and precise analysis of market depth, and (iii) confirm the availability of adequate management information systems and data to support these strategies.
- 20 **The SRB keeps the LAA consistent with its approach to bail-in.** The SRB assumes that the default LAA provided by the MREL DR formula accurately reflects the losses that the bank will incur in resolution, irrespective of the tool used.
- 21 **The SRB adjusts the RCA downwards to reflect the transfer of assets.** When the strategy relies primarily on a transfer tool (sale of business – share or asset deal, bridge institution and/or asset separation), the SRB will apply a scaling factor of minus 20% of total assets, a proxy reflecting the assets that would be transferred and/or liquidated under normal insolvency proceedings. This scaling factor applies to the RWA basis, and can be added to other bank-specific adjustments applied to the RCA, where relevant. The SRB expects a variant strategy for banks having a transfer strategy as their preferred one. The MREL formula to be applied will therefore depend on which variant is chosen. When the resolution plan envisages a variant strategy relying on an open-bank bail-in approach, the MREL target is based on the bail-in tool.
- 22 **The MREL approach applied to transfer strategies is an interim step towards a more tailored approach.** The SRB intends to further refine its policy on MREL for transfer strategies in order to reflect the perimeter of assets and liabilities likely to be transferred or sold in a resolution scenario and the different uses and combinations of tools.

B – QUALITY, SUBORDINATION AND ELIGIBILITY CRITERIA

Subordination policy

- 23 **Subordination improves resolvability and reduces the risk of breaching the NCWO principle.** Subordination can be considered a tool to improve resolvability by making the implementation of the bail-in tool feasible and credible. In particular, subordination addresses risks stemming from (i) having bail-in-able instruments ranking *pari passu* with operational liabilities and any other excluded liabilities prescribed by Article 44(2) of the BRRD or (ii) the discretionary power of the resolution authority to exclude some liabilities under exceptional circumstances (Article 44(3) of the BRRD).

⁽⁶⁾ Transfer strategies are resolution strategies that do not rely on the use of the bail-in tool (open-bank bail-in), but envisage the use of the sale of business tool, the bridge institution tool and/or the asset separation tool, in accordance with the legal framework.

- 24 **Subordination policy is composed of two elements:** a general level depending on the systemic importance of banks and a potential bank-specific add-on to address NCWO risks based on mandatory exclusions, the latter being for monitoring purpose only. The assessment of compliance with the relevant subordination levels will take into account all forms of subordination, including 'senior non-preferred' instruments, where they exist, subject to analysis in line with national laws. The SRB reserves the right to adjust this policy at a later stage in the light of the future design of the BRRD and further development of the MREL policy.
- 25 **The SRB expects from banks a minimum level of subordinated instruments, depending on the size and systemic importance of banks.** Banks pertaining to the first wave of resolution plans, and which have been identified as other systemically important institutions will be expected to fulfil a minimum percentage of subordinated instruments equal to 12% of RWA plus the CBR, pending further assessment of NCWO risks. This reference point acts as a proxy to improve resolvability and addresses potential *pari passu* issues.
- 26 **The SRB also monitors an NCWO add-on related to mandatory exclusions from bail-in.** In line with the DR, each time the mandatorily excluded liabilities as specified in Article 44(2) of the BRRD exceed a threshold of 10% of the relevant liability class, an assessment has to be performed regarding the possible risk of breaching the NCWO principle when applying the bail-in tool. As an interim step towards a more comprehensive approach to NCWO, the SRB uses this threshold to compute a subordination add-on, for monitoring purposes.
- 27 **In the next wave of resolution plans, the SRB has committed to further refining its subordination policy and the approach to NCWO issues.** This could lead to increase the required amount of subordination to address these risks.

Eligible liabilities and own funds are taken at consolidated level

- 28 **Compliance with binding targets will be assessed against eligible liabilities and own funds at consolidated resolution group level.** The SRB will consider the consolidated amount of own funds instruments and eligible liabilities issued either by the resolution entity itself or by the subsidiaries within the resolution group, provided these instruments meet the other eligibility criteria as set out in the BRRD and the specific options adopted by the SRB for its 2017 MREL policy (also listed in the present document). In practice, compliance with the binding MREL targets will be assessed by taking into account consolidated own funds and consolidated eligible liabilities at the level of the resolution group.
- 29 **For the next cycle, the SRB is considering a hybrid approach to assessing banks' future compliance with MREL targets.** Already this year, the SRB will consider a computation at the level of the point of entry, for information purposes only, taking into account own funds instruments eligible for the resolution entity's consolidated own funds requirement issued either by the resolution entity itself or by subsidiaries within the

resolution group and eligible liabilities issued by the resolution entity to entities outside the resolution group.

Structured notes are mostly excluded

30 **Structured notes:** in line with the 2017 SRB policy, the SRB excludes structured notes by default. However, the SRB will assess on a case-by-case basis the eligibility of such liabilities:

- 1) when a given amount of the liability arising from the instrument is known in advance at the time of issuance, is fixed (i.e. the amount cannot go below a minimum floor) and is not affected by a derivative feature;
- 2) if the instrument, including its derivative feature, is not subject to any netting agreement and its valuation is not subject to Article 49(3) of the BRRD;
- 3) only up to the amount of the liability that complies with point 1 (i.e. for the fixed floor of the liability that would have to be paid).

Non-covered non-preferred deposits breakable below one year are excluded

31 **The SRB will exclude non-covered non-preferred deposits if they can be withdrawn within a one-year horizon.** Some term deposits may have an early redemption clause that would have to be taken into account in the maturity assessment (Article 45(4) of the BRRD). In addition, according to the European Banking Authority, a 'deposit which is deposited for at least a year's period but which confers upon its 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' ⁽⁷⁾. As a result, the SRB is asking banks to conduct credible analyses of these deposits and will review them to exclude from the eligible instruments all non-preferred non-covered deposits above one year that have a redemption clause below one year or for which there is no sufficient evidence that they cannot be withdrawn.

Liabilities held by retail investors are MREL-eligible

32 **The SRB does not see any legal basis for resolution authorities to exclude *ex ante* and uniformly eligible liabilities held by natural persons or small and medium-sized enterprises from MREL or from bail-in.** The SRB is required to bail in retail investors in line with their ranking in the applicable creditor hierarchy, other than in exceptional circumstances, and cannot exclude instruments from MREL for the sole reason that they are held by retail investors should they otherwise meet the requirements for MREL. The European Union (EU) legislation includes many safeguards to ensure financial products are sold to suitable investors only. The implementation and supervision of such

⁽⁷⁾ EBA Q&A 2015/2267.

rules is 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 MREL targets or, finally, bail-in.

- 33 **However, holdings of subordinated or senior instruments by retail customers could prove to be an impediment to resolution.** As part of the resolvability assessment, the SRB will analyse the bank's exposure to retail bondholders to assess whether the bail-in of these counterparties might be an impediment to resolvability. Acknowledging the benefits of diversification for funding purposes, large holdings of liabilities sold to retail investors could make banks difficult to resolve for various reasons, including (i) the potential loss of a bank's customer base and the risk of withdrawals and (ii) potential litigation brought by retail investors upon or after resolution, which might endanger the bank's future viability.

Liabilities issued under third country law or by entities outside the EU are mostly excluded

- 34 **The SRB generally excludes liabilities governed by the laws of a country outside the EU.** When liabilities are not governed by EU law, resolution authorities face the risk that the courts of the country with legal jurisdiction over the liabilities may not recognise the bail-in or transfer order of an EU resolution authority. The SRB will generally not count towards MREL any liability governed by the law of a third country unless a bank is able to demonstrate that the write-down or bail-in of those liabilities would be recognised by the courts in that third country. Therefore, these liabilities may be included in MREL if the SRB assesses that the write-down or bail-in powers are contractually recognised as set out in Article 55 of the BRRD, based on legal opinions or other evidence satisfactory to the SRB.
- 35 **Liabilities issued by banks located outside the EU are not recognised as MREL-eligible.** Eligible liabilities must be issued by an entity that is located within the EU, otherwise it is possible that resolution authorities' powers may not be applied. However, the 2018 MREL policy still recognises minority interests in subsidiaries (i.e. own funds instruments issued to external investors) as MREL-eligible 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. the resolution strategy envisages that the foreign subsidiary would be resolved through the EU parent).
- 36 **Banks are expected to tackle proactively the possible impact of Brexit.** The SRB monitors the evolution of the stock and issuances of liabilities governed by UK law in the context of Brexit. Such liabilities are MREL-eligible based on the application of the current legal framework. However, the SRB will address on a case-by-case basis the possible effect of Brexit on the stock of MREL-eligible instruments. Meanwhile, banks are expected to include contractual recognition clauses in the new issuances of MREL-eligible instruments in accordance with Article 55 of the BRRD and be prepared to demonstrate that the



decisions of SRB will be effective. In addition banks are expected to consider issuing MREL-eligible instruments under the EU-27 governing laws to achieve legal certainty ⁽⁸⁾.

C — TRANSITION PERIOD

Bank-specific transition periods will support banks' efforts to reach MREL targets

- 37 **Binding MREL targets are set with a bank-specific transition period.** The SRB has decided to continue setting, as a general rule, individual transition periods of up to a maximum of four years. The transition periods are defined based on quantity (target) and quality (subordination level) expectations to pave the way for building up a bank's loss-absorbing and recapitalisation capacities. The transition periods take into account bank- and market-specific characteristics. For banks that already meet the binding target, there will generally be no transitional period. In addition, the SRB will set non-binding interim targets when the transition period exceeds two years to ensure the feasibility of reaching the target at the end of the transition period ⁽⁹⁾. The SRB may need to adjust future transition periods, shortening or lengthening them depending on the applicable conditions.

⁽⁸⁾ See also the expectations of the EBA stated in its Opinion of 25 June 2018 (EBA/Op/2018/05).

⁽⁹⁾ Interim targets are expressed as a percentage of total liabilities and own funds, in order to monitor compliance with the binding reference of the MREL decision (RWA and nominal amount can be used for information purposes).

CONCLUSION AND NEXT STEPS

- 38 **The 2018 SRB policy for banks pertaining to the first wave of resolution plans updates the MREL 2017 approach by introducing new elements.** In particular, the applicable policy for banks subject to transfer strategies represents an additional step to tailor MREL targets to bank-specific features, pending further refinement to reflect the perimeter of assets and liabilities likely to be transferred or sold in a resolution scenario. Setting binding decisions for a much wider scope of banking groups will also strengthen the resolvability of the Banking Union banks as a whole.
- 39 **MREL decisions are reviewed annually.** In accordance with the legislation, the SRB will continue revising the applicable MREL targets and transition periods as part of the future resolution planning cycles. In particular, the SRB will take into consideration any change stemming from supervisory decisions or linked to the evolution of banks' risk profiles and overall structures.
- 40 **The development of the MREL policy will continue in 2018 for the second wave of resolution plans, that is banks with RCs.** With a view to improving banks' resolvability and tailoring the calibration of MREL targets to bank-specific characteristics, the SRB will update its general MREL policy, paying particular attention to subordination, eligible instruments and individual MREL targets.



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