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MINIMUM REQUIREMENTS FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL): A COMPREHENSIVE ANALYSIS OF THE NEW PRUDENTIAL REQUIREMENT FOR CREDIT INSTITUTIONS

by Ph.D. Candidate Nikos G. Maragopoulos

September 2016 - Updated -

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Nikos G. Maragopoulos
Ph.D. Candidate, Department of International, European and Area Studies, Panteion University of Athens

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Address
Panteion University of Social and Political Sciences
Department of International, European and Area Studies
136 Sygrou Ave.
GR-17671, Athens
Greece

Internet
http://www.ecefil.eu

Contact
info@ecefil.eu

Coordinator, Design
ECEFIL, Dr. Ziakou Sophia

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Minimum Requirement for Own Funds and Eligible Liabilities (MREL): A comprehensive analysis of the new prudential requirement for credit institutions

Nikos G. Maragopoulos*

September 2016 (updated)

Abstract

The global financial crisis of 2007-2009 triggered a political initiative for a radical reform of the EU bank safety net aiming to enhance financial stability. The establishment of the Minimum Requirement for own funds and Eligible Liabilities (MREL) is one of the new core elements of the Union legal framework seeking to ensure that credit institutions have loss absorbing capacity sufficient to achieve their orderly resolution in case they become unviable. The present working paper, structured in four (4) sections, analyses the components of the new prudential requirement, as well as its potential impact on the EU banking system.

Nikos Maragopoulos is (since May 2014) a Ph.D. Candidate at the Department of International, European and Area Studies of Panteion University of Athens. The subject of the thesis is “Cross-border supervision and resolution of significant banking groups in the context of the European Banking Union”. He holds a BA in “International and European Studies” (2010) and an MA in “International Economic, Financial and Banking Law” (2013) from the Department of International and European Studies of Panteion University of Athens. Moreover, he holds an M.Sc. in “Finance and Banking for Executives” from Athens University of Economics and Business. Since 2013 he is Advisor in the General Secretariat of the Hellenic Bank Association (HBA).

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List of Abbreviations

BRRD	Bank Recovery and Resolution Directive
CET1	Common Equity Tier 1
CRD IV	Capital Requirements Directive IV
CRR	Capital Requirements Regulation
DGS	Deposit Guarantee Scheme
DGSD	Deposit Guarantee Schemes Directive
EBA	European Banking Authority
EBU	European Banking Union
ECB	European Central Bank
EU	European Union
FSB	Financial Stability Board
G-SIIs	Global Systemically Important Institutions
MIFID II	Markets in Financial Instruments Directive no. II
MPE	Multiple Point of Entry
MREL	Minimum Requirement for own funds and Eligible Liabilities
O-SIIs	Other Systemically Important Institutions
QIS	Quantitative Impact Study
OJ	Official Journal of the European Union
RTS	Regulatory Technical Standards
RWAs	Risk Weighted Assets
SREP	Supervisory Review and Evaluation Process
SRB	Single Resolution Board
SRM	Single Resolution Mechanism
SRMR	Single Resolution Mechanism Regulation
SRF	Single Resolution Fund
SPE	Single Point of Entry
SSM	Single Supervisory Mechanism
SSMR	Single Supervisory Mechanism Regulation
TFEU	Treaty on the Functioning of the European Union
TLAC	Total Loss Absorbency Capacity

Executive summary

The adoption, for first time, in the European banking law of common resolution rules applicable across Member States consists a significant initiative towards ensuring financial stability by containing the failure of credit institutions without recourse to bail-outs with public funds. The effectiveness and credibility of the new ***European Union*** (henceforth the '**EU**') resolution framework (**Chapter 1**) is strongly dependent on the implementation of the new prudential requirement that institutions have to comply with as of 2016, the ***Minimum Requirement of own funds and Eligible Liabilities*** (hereinafter the '**MREL**').

In particular, the obligation of credit institutions to hold a buffer of own funds instruments and liabilities subject to write-down and conversion into equity is of particular importance for resolution authorities in order to apply effectively and in a timely consistent manner the resolution tools and powers stipulated in the ***Directive 2014/59/EU on recovery and resolution of credit institutions and investment firms*** (hereinafter the '**BRRD**').

In contrast to minimum capital requirements (***8% of Risk Weighted Assets***, hereinafter the '**RWAs**') uniformly applicable to all credit institutions, the MREL ratio would be determined (**Chapter 2**) by resolution authorities on a case-by-case basis for each credit institution taking account of:

- certain characteristics of each credit institution, and
- the provisions of resolution planning.

In a nutshell, the MREL with which a credit institution is obliged to comply is the sum of the following two components:

1) the ***loss absorption amount***, which would be (usually) equal to total capital requirements applicable to the credit institution concerned, and
2) the ***recapitalisation amount***, which would be the amount of own funds and eligible liabilities that, if written down or converted into equity, would allow the credit institution:
    - to meet the applicable capital requirements necessary to comply with the conditions for authorisation after the implementation of the preferred resolution strategy, and
    - to hold any additional amount of own funds necessary to maintain sufficient market confidence after resolution, if the resolution authority deems it appropriate.

The sum of the above-mentioned amounts is downwards or upwards adjusted by the following factors:

1) the '***no creditor worse off principle' ('NCWO') adjustment***, which implies that if liabilities likely to be excluded from the bail-in, provided that they satisfy certain conditions, total more than 10% of any class of liabilities ranking equally in insolvency, resolution authorities adjust the composition and the level of the MREL in order to avoid the breach of 'no creditor worse off principle' in case of resolution, and
2) the ***MREL downwards adjustment because of the possible contribution of Deposit Guarantee Schemes***, that is the reduction of the MREL equal to the amount that the relevant ***Deposit Guarantee Scheme*** (hereinafter the '**DGS**') is expected to contribute to financing resolution costs.

In the aftermath of the financial crisis, regulatory authorities at international and EU level laid down stringent measures to tackle with the problems that triggered the crisis, mainly in the areas of capital adequacy and liquidity management. The establishment of the MREL is plausible to consider that would be a further heavy burden for credit institutions. Therefore, the introduction of a transitional period (**Chapter 3**) would grant credit institutions with the necessary timeframe to meet the MREL, limiting the inevitable negative implications its adoption implies for the ability of credit institutions to raise equity and debt funds and, in their turn, to finance the economy.

According to the impact assessment carried out by the European Banking Authority (henceforth the '**EBA**'), in a sample of 64 credit institutions the estimated MREL shortfall ranges from a few dozens of billions to several hundreds of billions depending on qualification or not of senior unsecured bonds in the MREL. Since in insolvency proceedings senior unsecured debt ranks *pari passu* with other senior unsecured liabilities, such as corporate deposits, the exclusion of the latter from the scope of bail-in is likely to breach the 'no creditor worse off principle'.

Consequently, the amendment of national insolvency law by establishing (statutorily or contractually) the subordination (**Chapter 4**) of senior unsecured debt to corporate deposits exceeding coverage level (i.e. 100.000 euros per depositor per credit institution) is prerequisite not only for credit institutions to meet the MREL, but also for the effective implementation of resolution tools avoiding legal challenges.

A. The new EU resolution framework in the context of the European Banking Union

1. The main pillars of the European Banking Union

The recent financial crisis (2007-2009) forced governments to rescue failing credit institutions by injecting capital in order to recapitalise them. The massive capital injection had negative consequences on public finances leading to increase of fiscal deficit and public debt. In addition, bail-outs with public funds highlighted the moral hazard issue stemming from using taxpayers' money to rescue failed credit institutions preventing investors and senior executives from bearing the full consequences of the excessive risk-taking. Therefore, a credible resolution mechanism is important for managing the failure of a credit institution in an orderly manner without recourse to public funds, enhancing market discipline and reducing moral hazard.[1]

The EU initiative for the establishment of a common resolution framework coincided with the fiscal crisis in the euro area that affected the banking sector of several Member States. On 6 June 2012, the ***European Commission*** (henceforth the '**Commission**') submitted a proposal for a Directive "on establishing a common framework for the recovery and resolution of credit institutions and investment firms".[2] A few days later, at the peak of the euro area crisis, at the Euro Area Summit of 29 June 2012, the Eurozone leaders took the initiative to build the ***European Banking Union*** (hereinafter the '**EBU**'), seeking to address the deficiencies of the EU financial system having arisen amidst the financial and fiscal crisis.[3]

The establishment of the EBU, considered to be the most significant political initiative since the creation of the Economic and Monetary Union, was realised in a particular short timeframe. The main pillars of the EBU are:

- the ***Single Supervisory Mechanism*** (hereinafter the '**SSM**'), which was established under the **Council Regulation 1024/2013** and is competent since 4 November 2014 for the supervision of credit institutions incorporated in the participating in the EBU Member States,[4]

- the ***Single Resolution Mechanism*** (hereinafter the '**SRM'**), competent for the resolution of failing credit institutions established in the participating in the EBU Member States, complemented by the ***Single Resolution Fund*** (hereinafter the '**SRF**'),

[1] For a more thorough analysis of the role of banking resolution, see indicatively, **Binder (2015b), Binder (2014)** and **Wiggings, Tente and Metrick (2014)**.

[2] **European Commission (2012):** Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, June, COM(2012) 280 final

[3] For more information on the EBU, see indicatively, **Binder (2015a), European Central Bank (2014), Gortsos (2014b)**.

[4] On the SSM see indicatively, **Dietz (2014), Gortsos (2015b), Gortsos (2013), Guarracino (2013), Wymmersch (2015), Wymmersch (2014), Ferran and Babis (2013)**.

- the ***Single Rulebook***, which contains substantive rules in the area of financial services aiming at a 'total harmonisation approach' applicable across EU Member States.[5] The Single Rulebook consists of the following legal acts:
  - the ***Directive 2013/36/EU*** of the European Parliament and of the Council "on access to the activity of credit institutions and the prudential supervision of credit institution and investment firms (…)" ('***Capital Requirements Directive***' henceforth the '**CRD IV**'),
  - the ***Regulation (EU) No 575/21013*** of the European Parliament and of the Council "on prudential requirements for credit institutions and investment firms (…)" ('***Capital Requirements Regulation***', hereinafter the '**CRR**'),
  - the ***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 (…)" ('***Bank Recovery and Resolution Directive***', or the '**BRRD**'),
  - the ***Directive 2014/49/EU*** of the European Parliament and of the Council "on deposit guarantee schemes" ('***Deposit Guarantee Schemes Directive***', hereinafter the '**DGSD**'), and
  - the ***Commission Delegated*** and ***Implementing Regulations*** and the ***EBA Guidelines*** adopted pursuant to the aforementioned legislative acts.

The EBU will be considered complete, when a Single Deposit Guarantee Scheme would be established being liable for compensating covered depositors in case of winding up an insolvent credit institution under normal insolvency proceedings. In this context, on 24 November 2015 the Commission submitted a proposal for a Regulation for the establishment of a European Deposit Insurance Scheme.[6]

Participating in the EBU Member States are:

- the Member States whose currency is the euro, and
- the Member States with a derogation which have established a close cooperation in accordance with **Article 7 SSMR**.

2. The core elements of the new EU framework for recovery and resolution of credit institutions

It is worth mentioning that with the adoption of the BRRD it is the first time that harmonised rules have been established at Union level in the field of resolution of credit institutions. Until recently, there was no common legal framework at EU level in respect of this area, but only national arrangements adopted by some Member States aiming to handle -at national level- failures of credit institutions.

In April 2014 the European Parliament and the Council adopted the BRRD, which was published in the ***Official Journal of the European Union*** (hereinafter the '**Official Journal**' or the '**OJ**') on 12 June 2014, and is applicable since 1 January 2015.

The BRRD is a Directive of minimum harmonisation establishing rules and procedures related to the recovery and resolution of credit institutions. According to **Article 1(2) BRRD**, Member States may adopt or maintain rules that are stricter or additional to

[5] See **Gortsos (2015b)**, p.4.

[6] **European Commission (2015):** *Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme*, COM(2015) 586 final.

those laid down in the BRRD and in the delegated and implementing acts adopted pursuant to it, provided that they are of general application and do not conflict with the aforementioned legal acts.

The BRRD contains provisions on three (3) main fields:

- ***preparatory measures***, including recovery plans, resolution planning and intra-group financial support agreements (**Articles 4-26 BRRD**),
- ***early intervention measures,*** aiming at reversing **a** significant deterioration in the financial situation of an institution (**Articles 27-30 BRRD**), and
- ***resolution tools and powers,*** which consist the main corpus of the BRRD **(Articles 31-86 BRRD)**.

The exercise of the aforementioned tasks, excluding assessment of recovery plans, is assigned to resolution authorities. In particular, each Member State designates one or more public administrative authorities as resolution authority empowered, *inter alia*, to apply resolution tools and exercise resolution powers. When executing the tasks related to resolution of failing institutions, resolution authorities must:

- give due consideration to resolution objectives described in **Article 31(2) BRRD**,
- choose the resolution tools and powers that best achieve the resolution objectives,
- take a resolution action in respect of an institution, where they assess whether the conditions for putting it in resolution are fulfilled in accordance with **Article 32 BRRD**,
- take all appropriate measures to ensure that the resolution action is taken pursuant to general principles governing resolution referred to in **Article 34 BRRD.**

Where the resolution authority concludes that an institution meets the conditions for resolution pursuant to **Article 32 BRRD**, it takes resolution action by applying - individually or in any combination- the following resolution tools:

i. the ***sale of business tool***, which is defined as the mechanism for effecting a transfer by a resolution authority of shares or other instruments of ownership issued by a credit institution under resolution, or assets, rights or liabilities, of a credit institution under resolution to a purchaser that is not a bridge institution in accordance with the provisions of **Articles 38-39 BRRD**,[7]

ii. the ***bridge institution tool***, which is the mechanism for transferring shares or other instruments of ownership issued by a credit institution under resolution, or assets, rights or liabilities of a credit institution under resolution to a bridge institution pursuant to Articles **40-41 BRRD**,[8]

iii. the ***asset separation tool***, which is the mechanism for effecting a transfer by a resolution authority of assets, rights or liabilities of a credit institution under resolution to an asset management vehicle in accordance with **Article 42 BRRD**,[9] and

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[7] **BRRD**, Article 2(1), point (58).

[8] *Ibid*, Article 2(1), point (60).

[9] *Ibid*, Article 2(1), point (55).

iv. the ***bail-in tool***, which is the mechanism for effecting the exercise by a resolution authority of the write-down and conversion powers in relation to liabilities of a credit institution under resolution pursuant to the provisions of **Articles 43-44** and **46-58 BRRD.**[10]

3. The Single Resolution Mechanism

The second pillar of the EBU, the SRM, established under the ***Regulation 806/2014*** of the European Parliament and of the Council "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 (…)" (the '**SRM Regulation**', hereinafter the '**SRMR**'), became fully operational since 1 January 2016.[11]

The SRMR sets uniform rules and a uniform procedure for the orderly resolution of credit institutions (as well as of other entities included in its scope of application).[12] These uniform rules and this uniform procedure must be applied by the ***Single Resolution Board*** (hereinafter the '**SRB**') established in accordance with **Article 42 SRMR**, together with the Council, the Commission and the national resolution authorities within the framework of the SRM.

The SRM is a necessary complement to the SSM, as it would be a paradox, if credit institutions were directly supervised by a supranational authority (i.e. the European Central Bank, henceforth the '**ECB**'), but, in the event of a need for resolution (upon proposal by the ECB), the relevant decision was taken at national level.[13]

The SRMR establishes under **Article 114 Treaty on the Functioning of the European Union** (henceforth the '**TFEU**') the SRF competent for covering resolution costs arising from the implementation of the resolution tools. The SRF will replace the national resolution arrangements of the participating in the EBU Member States set up under the **Article 100 BRRD**. The SRF will be financed by the incorporated in participating Member States institutions through ex-ante contributions. Until the end of 2023 it should reach a target level of 1% of the amount of covered deposits of credit institutions located in the participating Member States (approximately **55 billion euros**).[14] 26 Member States signed an ***intergovernmental agreement*** (only Sweden and the United Kingdom are not Contracting Parties) laying down rules on:[15]

- transferring to the SRF the contributions raised at national level in accordance with the BRRD and the SRMR, and
- allocating, during the transitional period (2016 to 2023), the contributions raised at national level to different compartments of the SRF corresponding to each Contracting Party. The use of the compartments would be subject to a progressive mutualisation in such a manner that they would cease to exist at the end of the transitional period.

[10] *Ibid*, Article 2(1), point (57).

[11] For more details on the SRM, see **Gortsos (2015a), Wymmersch (2015)** and **Zavvos and Kaltsouni (2015)**.

[12] **SRMR**, Article 1.

[13] **Gortsos (2015a)**, p. 20.

[14] For more information on the SRF, see **Gortsos (2015a)** and **Hadjiemmanuil (2015)**.

[15] **IGA (2014):** Article 1.

B. The core elements of the MREL

1. Rationale for introducing the MREL

The BRRD establishes a framework aiming to ensure that credit institutions themselves, along with their shareholders, creditors and other stakeholders, bear the costs of a potential failure. However, the BRRD provides resolution authorities with the discretion to exempt certain liabilities from absorbing losses in resolution, where:[16]

- it is not possible to bail-in such liabilities within a reasonable timeframe,
- the exclusion is strictly necessary and proportionate to achieve the continuity of critical functions and core business lines,
- the application of the bail-in tool to those liabilities would cause such a destruction in value that losses borne by other creditors would be higher than if those liabilities were not excluded from bail-in, and
- it is necessary to avoid the spreading of contagion and financial instability, which may cause serious disturbance to the economy of a Member State.

This exemption constitutes an incentive for credit institutions to raise greater proportion of their funding from those liabilities. To guard against this, the BRRD requires institutions to meet the MREL at all times towards which only eligible liabilities satisfying certain conditions count that enable resolution authorities to exercise write-down and conversion powers in an effective and timely consistent manner.

The MREL is designed to ensure that credit institutions have enough loss-absorbing capacity. Meeting the MREL implies that an unsound credit institution can be recapitalised in an orderly manner through the write-down or conversion of its capital instruments and eligible liabilities avoiding a need for a bail-out with public funds and without or limited recourse to financial means of resolution financing arrangements.

2. General provisions of the MREL

The BRRD scope of application contains the following entities:

a) ***credit institutions***[17] and ***investment firms***[18] **(jointly referred to hereinafter as *institutions*)** incorporated in the Union,

b) ***financial holding companies***[19], ***mixed financial holding companies***[20] and ***mixed-activity holding companies***[21] established in the Union,

[16] **BRRD**, recital 72.

[17] ‘Credit institutions’ means a credit institution as defined in Article 4(1), point (1) **CRR**, not including the entities referred to in Article 2(5) CRD IV.

[18] ‘Investment firms’ means an investment firm as defined in Article 4(1), point (2) **CRR** that is subject to the initial capital requirement laid down in Article 28(2) CRD IV.

[19] ‘Financial holding companies’ means a financial holding company as defined in Article 4(1), point (20) **CRR**.

[20] ‘Mixed financial holding companies’ means a mixed financial holding company as defined in Article 4(1), point (21) **CRR**.

[21] ‘Mixed-activity holding companies’ means a mixed-activity holding company as defined in Article 4(1), point (22) **CRR**.

c) ***parent financial holding companies*** in a Member State[22], ***Union parent financial holding companies***[23], ***parent mixed financial holding companies*** in a Member State[24], ***Union parent mixed financial holding companies***[25],

d) ***financial institutions***[26] established in the Union, when the financial institution is a subsidiary of an entity referred to above in points a), b) or c), and is covered by the supervision of the parent undertaking on a consolidated basis pursuant to **Articles 6-17 CRR**, and

e) ***branches***[27] ***of institutions*** incorporated outside the Union in accordance with the specific conditions laid down in the BRRD.

Article 45(1) BRRD requires **institutions** to meet, at all times, the MREL, which is calculated as a percentage of the ***institution's amount of own funds and eligible liabilities*** (nominator) over its ***total liabilities and own funds*** (denominator).[28] In the total liabilities are included derivative liabilities, given that full recognition is given to counterparty netting rights.

It is worth mentioning that in contrast to minimum capital requirements, the MREL:

- is determined on a case-by-case basis, since there is no single requirement applicable to all institutions, as applies to minimum capital requirements pursuant to **Article 92(1) CRR**, and
- is calculated over institution's total liabilities and own funds, which equal to total assets, whereas capital requirements are estimated over RWAs, which are always lower than total assets.

According to **Article 45(7) BRRD**, institutions must satisfy the MREL on an individual basis and with regard to the entities referred to in the above-mentioned **points b)**, **c)** and **d)**, the resolution authority may, after consulting the relative supervisory authority, decide to apply also on them the MREL on a solo basis. In addition, Union parent undertakings must comply with the MREL on a consolidated basis, whose level will be determined by the group-level resolution authority[29], after consulting the consolidating supervisor[30] in accordance with the procedure described below (in Section 3, under 2).

However, **Article 45(3) BRRD** provides that resolution authorities must exempt mortgage credit institutions financed by covered bonds which, according to national law are not allowed to receive deposits, from the obligation to meet, at all times, the MREL, as:

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[22] 'Parent financial holding company in a Member State' means a parent financial holding company in a Member State as defined in Article 4(1), point (30) **CRR**.

[23] 'Union parent financial holding company' means an EU parent financial holding company as defined in Article 4(1), point (31) **CRR**.

[24] 'Parent mixed financial holding company in a Member State' means a parent mixed financial holding company in a Member State as defined in Article 4(1), point (32) **CRR**.

[25] 'Union parent mixed financial holding company' means an EU parent mixed financial holding company as defined in Article 4(1), point (33) **CRR**.

[26] 'Financial institution' means financial institution as defined in Article 4(1), point (26) **CRR**.

[27] 'Branch' means a branch as defined in Article 4(1), point (17) **CRR**.

[28] **BRRD**, Article 45(1).

[29] 'Group-level resolution authority' means the resolution authority in the Member State in which the consolidating supervisor is situated.

[30] 'Consolidating supervisor' means consolidating supervisor as defined in Article 4(1), point (41) **CRR**.

a) those institutions would be wound-up through national insolvency procedures, or other types of procedure implemented in accordance with **Articles 38, 40 or 42 BRRD**, provided for those institutions, and

b) such national insolvency procedures, or other types of procedure, would ensure that creditors of those institutions, including holders of covered bonds where relevant, would bear losses in a way that meets the resolution objectives.

3. Liabilities eligible to count towards the MREL

The nominator of the MREL ratio includes the following instruments:

- ***own funds instruments*** satisfying the criteria for qualification in own funds pursuant to the provisions of the **CRR**, and
- ***eligible liabilities***, which fulfill certain criteria described in **Article 45(4) BRRD**.

In particular, pursuant to **Article 45(4) BRRD**, instruments and eligible liabilities can be included in the amount of the MREL, only if they satisfy the following conditions:

a) the instrument is issued and fully paid up,

b) the liability is not owed to, secured by or guaranteed by the institution itself,

c) the purchase of the instrument was not funded directly or indirectly by the institution,

d) the liability has a remaining maturity of at least one year and where a liability confers upon its owner a right to early reimbursement, the maturity date of that liability must be the first date where such a right arises,

e) the liability does not arise from a derivative, and

f) the liability does not arise from a deposit, which benefits from preference in the national insolvency hierarchy in accordance with **Article 108 BRRD**.

Where a liability is governed by the law of a third-country, the resolution authority may require the institution to demonstrate that any decision of the resolution authority to write down or convert that liability would be effective under the law of that third country, with regard to the terms of the contract governing the liability, international agreements on the recognition of resolution proceedings and other relevant matters. If the resolution authority is not satisfied that any decision would be effective under the law of that third country, the liability must not be counted towards the MREL.[31]

[31] **BRRD,** Article 45(5).

4. Criteria for determining the MREL

The MREL must be determined by resolution authorities on a case-by-case basis allowing them to take into account the specific features of each institution. However, to ensure a sufficient degree of harmonisation across Member States, the BRRD assigned to the EBA the task to develop regulatory technical standards in order to specify the criteria pursuant to which the resolution authorities will set the MREL for each institution. In this context, according to **Article 45(6) BRRD**, the resolution authority must determine, after consulting the relative supervisory authority, the MREL at least on the basis of the following criteria:

a) 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 meets the resolution objectives,

b) the 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 (hereinafter the 'CET1') 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 continue to carry out the activities for which it is authorised under CRD IV (for credit institutions) or *Directive 2014/65/EU* (Markets in Financial Instruments Directive no. II, hereinafter the 'MIFID II') (for investments firms) and to sustain sufficient market confidence in the institution or entity,

c) the need to ensure that, if the resolution plan anticipates that certain classes of eligible liabilities might be excluded from bail-in under Article 44(3) BRRD or that certain classes of eligible liabilities might be transferred to a recipient in full under a partial transfer, that the institution has sufficient other eligible liabilities to ensure that losses could be absorbed and the CET1 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 continue to carry out the activities for which it is authorised under CRD IV or MIFID II,

d) the size, the business model, the funding model and the risk profile of the institution,

e) the extent to which the DGSs could contribute to the financing of resolution in accordance with Article 109 BRRD, and

f) the extent to which the failure of the institution would have adverse effects on financial stability, including, due to its interconnectedness with other institutions or with the rest of the financial system through contagion to other institutions.

Within the timeframe set by the co-legislators, on 3 July 2015, the EBA submitted to the Commission the relevant draft regulatory technical standards (***EBA FINAL Draft Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU, EBA/RTS/2015/05,*** *hereinafter the* ***'EBA RTS on MREL'***).[32]

[32] For more information on the draft RTS on MREL, see **EBA RTS (2015)**.

In brief, according to the draft RTS submitted by the EBA, the MREL an institution would be obliged to comply with would be the sum of the following two components:

- the ***loss absorption amount***, and
- the ***recapitalisation amount***,

adapted by the following factors:

- the '***no creditor worse off principle' adjustment***,
- the ***downward adjustment because of the possible contribution of the DGS***, and
- the ***8% of total liabilities and own funds floor constraint*** in respect of G-SIIs and O-SIIs.

On 17 December 2015, pursuant to Article 10(1), fifth sub-paragraph of Regulation 1093/2010 *(hereinafter the* '**EBA Regulation**'*),* the Commission proposed a number of amendments to the RTS submitted by the EBA. In particular, the Commission objected to the EBA's proposal to lay down a harmonised minimum MREL level of 8% of total liabilities and own funds for all institutions identified as G-SIIs or O-SIIs. Furthermore, the Commission disagreed with the provisions of the EBA RTS on MREL concerning the transitional period, according to which resolution authorities could determine a maximum transitional period of 48 months for institutions to reach the MREL target level. The Commission amended Article 8 of the EBA RTS on MREL in such a way that allows resolution authorities to determine an appropriate transitional period as short as possible.

The EBA reacted to the Commission's proposals by issuing on 9 February 2016 an Opinion addressed to the Commission.[33] With regard to the 8% of total liabilities and own funds constraint in respect of G-SIIs and O-SIIs, the EBA insisted on its proposal, since it "disagreed with the Commission's assessment that the reference to the minimum burden-sharing contribution is an unlawful specification of the MREL criteria. Indeed, resolution authorities that fail to take it into account would not, in the EBA's view, be acting in accordance with Directive 2014/59/EU". Also, the EBA disagreed with the amendment proposed by the Commission to remove the 48 month limit for the transitional period because "replacing a clear-cut deadline with more ambiguous wording may affect legal certainty and the harmonised application of the MREL throughout the European Union (EU), thus contradicting the underlying rationale of the enactment of an EU-Delegated Regulation".

On 23 May 2016, the Commission adopted a Delegated Regulation on MREL without incorporating the aforementioned comments included in the Opinion of the EBA. The European Parliament and the Council did not raise any objection to the Commission Delegated Regulation within the timeframe provided for in **Article 13 EBA Regulation**.

On 3 September 2016 was published in the Official Journal of the European Union the **Commission Delegated Regulation (EU) 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" (*hereinafter the* '**Commission Delegated Regulation 2016/1450**') based on which resolution authorities must determine the level of MREL institutions have to comply with.

[33] For more information, see **EBA Opinion (2016)**.

4.1 Determining the loss absorption amount

The first component of the MREL, the ***loss absorption amount***, serves as a capital cushion aiming at absorbing losses incurred by an institution. Unless otherwise determined by the resolution authority, it mainly consists of the capital instruments already issued by the institution in order to comply with the applicable own funds requirements set by the supervisory authority in accordance with the provisions of the CRR and the CRD IV.

The resolution authority determines the loss absorption amount that an institution must satisfy in accordance with either of the following methods:[34]

i. **setting a default loss absorption amount,** which is equal to the capital requirements applicable to the institution based on the relative decisions of the supervisory authority, or

ii. **setting an adjusted loss absorption amount,** which derives from the decision of the resolution authority to set - based on certain conditions- a loss absorption amount higher or lower than the default loss absorption amount.

With regard to the **first method**, the resolution authority requests from the supervisory authority a summary of the capital requirements applicable to the institution and sets the ***default loss absorption amount***, which is the **highest** of the requirements referred to in points **a), b) or c)**:[35]

a) capital requirements consisting of the following components:

i. ***own funds requirements*** pursuant to **Articles 92** and **458 CRR**, which include:

- CET 1 capital ratio of 4.5% of RWAs,
- Tier 1 capital ratio of 6% of RWAs,
- total capital ratio of 8% of RWAs.

ii. any ***additional own funds requirements*** imposed on the institution in the context of the ***Pillar II*** (Article 104(1), point (a) **CRD IV**), and

iii. combined buffer requirements (Article 128(1), point (6) **CRD IV**).

b) the Basel I floor (Article 500 **CRR**),

c) any applicable **leverage ratio requirement**.

Capital requirements must be computed according to transitional provisions laid down in the CRR, as well as to the provisions of national legislation exercising the options granted to the supervisory authorities by the CRR.[36]

Concerning the **second method** for the determination of the loss absorption amount, the resolution authority may adjust the default loss absorption amount:

a) either by increasing this amount, if it considers that:

- the need to absorb losses in resolution is not fully reflected in the default loss absorption amount, taking into account information that requested from the supervisory authority related to the institution's business model, funding model and risk profile, according to those mentioned below (under 4.3), or

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[34] **Commission Delegated Regulation 2016/1450,** Article 1(5).

[35] *Ibid*, Article 1(2).

[36] *Ibid*, Article 1(3).

- this is necessary to reduce or remove an impediment to resolvability or absorb losses on holdings of MREL instruments issued by other group entities,

b) **either by lowering this amount**, if it considers that, after taking into account information received from the supervisory authority related to the institution's business model, funding model and risk profile:

- additional own funds requirements imposed on the institution in the context of Pillar II, which have been determined on the basis of the outcome of stress tests or to cover macroprudential risks, are assessed not to be relevant to the need to ensure that losses can be absorbed in resolution, or

- part of the combined buffer requirement is assessed not to be relevant to the need to ensure that losses can be absorbed in resolution.

In case that the resolution authority adjusts the default loss absorption amount, it is obliged to provide the supervisory authority with a reasoned explanation of the loss absorption amount that has set.[37]

According to **Article 128, point (6)** and **Article 131(14) CRD IV**, in respect of banking groups, the ***combined buffer requirement*** contains the following components:

a) a ***capital conservation buffer*** in accordance with **Articles 129** and **160 CRD IV**,

b) an ***institution-specific countercyclical capital buffer***, where applicable, calculated in accordance with **Articles 130, 135-140** and **160 CRD IV**, and

c) the **highest** of the following ones:

- a ***Global Systemically Important Institution buffer*** (*'G-SII buffer'*), calculated pursuant to **Articles 131** and **162 CRD IV**,

- an ***Other Systemically Important Institution buffer*** (*'O-SII buffer'*), computed in accordance with Article **131 CRD IV**, and

- a ***systemic risk buffer***, calculated according to Articles **133-134 CRD IV**.

4.2 Determination of the recapitalisation amount

4.2.1 General remarks on recapitalisation amount

After capital instruments, which mainly constitute the loss absorption amount, have absorbed losses, the resolution authority exercises the write-down and conversion powers -by applying the bail-in instrument or any other resolution tool- in order to recapitalise the institution in an effective and timely consistent manner ensuring continuity of its critical functions.

The second component of the MREL, the ***recapitalisation amount***, is defined as the pre-resolution amount of institution's own funds and eligible liabilities, excluding those for purposes of loss absorption amount, over its post-resolution RWAs. The resolvability assessment of the institution carried out in the context of drawing up the resolution plan, is of critical importance for the purpose of determining the level of the recapitalisation amount. To be exact, the recapitalisation amount depends, to a great extent, on the assessment of resolvability, given the fact that:

- if the resolution authority deems that winding up the institution under normal insolvency proceedings would be credible and feasible, it may not set a recapitalisation amount which implies that the total MREL would be lower,

[37] *Ibid*, Article 1(6).

- if the resolution authority determines that the resolution of the institution is necessary for the public interest, it must set a recapitalisation amount, whose level depends on its assessment for the post-resolution RWAs of the institution concerned,
- based on the preferred resolution strategy, the resolution authority decides on the internal allocation of the MREL within banking groups in order to ensure the effective implementation of the resolution plan, taking account of operational and legal challenges and constraints arising from the fact that various group's entities are subject to different national insolvency and corporate laws.

4.2.2 The role of resolution planning and resolvability assessment for the determination of the recapitalisation amount

4.2.2.1 Content of resolution plans

The BRRD introduces an innovative element in the context of crisis management, the obligation of resolution authorities to draft resolution plans. Robust resolution planning in advance is a cornerstone for the effective resolution of an institution, since it provides for the resolution actions that the resolution authority may take if the institution concerned meets the conditions for resolution, as described in **Article 32 BRRD**. **Articles 10-14 BRRD** lay down arrangements on:

- the content of resolution plans,
- the procedure for drawing up a resolution plan on stand-alone, solo and consolidated basis, and
- the cooperation among supervisory authorities and resolution authorities of the Member States in which the entities consisting of a banking group are established.

Further provision on content of resolution plans and resolvability assessment are included in Articles 23-32 of the **Commission Delegated Regulation (EU) 2016/1075** of 23 March 2016 "supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges" (*hereinafter the* '**Commission Delegated Regulation 2016/1075**').

The resolution authority must draw up a resolution plan for an institution, which must be reviewed, and where appropriate updated, at least annually and after any material changes to the legal or organisational structure of the institution or to its business or its financial position that could have a material effect on the effectiveness of the plan or otherwise necessitates a revision of the resolution plan.[38] A resolution plan must contain:

- the information required under **Articles 10 and 12 BRRD,**
- the information provided for in **Article 22 of** the **Commission Delegated Regulation 2016/1075**, and

[38] **BRRD**, Article 10(6).

- any additional information necessary to enable the delivery of the resolution strategy

Among the elements specified in the aforementioned points, resolution plans must contain:

- a detailed description of the ***assessment of resolvability***,
- a description of any ***measures*** required by the resolution authority ***to address or remove impediments to resolvability*** as a result of the resolvability assessment, and
- ***the level of the MREL that the institution is required to meet*** and the ***deadline*** to reach that level.

4.2.2.2 Resolvability assessment

The resolution authority, in the context of drawing up and updating the resolution plan, carries out a resolvability assessment of the institution.[39] In the context of the resolvability assessment, the resolution authority must assess the extent to which an institution is ***resolvable*** without the assumption of any of the following:[40]

- any extraordinary public financial assistance besides the use of the resolution financial arrangements,
- any central bank emergency liquidity assistance, and
- any central bank liquidity assistance provided under non-standard collateralisation, tenor and interest rate terms.

An institution must be considered as ***resolvable*** if the resolution authority considers that it is ***feasible*** and ***credible***:

- either to liquidate it under normal insolvency proceedings, or
- to resolve it by applying the different resolution tools and powers, while avoiding to the maximum extent possible any significant adverse effect on the financial system and with a view to ensuring the continuity of critical functions carried out by the institution.

In assessing the resolvability of an institution, the resolution authority is obliged to examine, at least, the matters specified in Section C of the Annex of the BRRD.[41]

The assessment of resolvability is implemented in the following stages:[42]

i. firstly, the resolution authority explores the ***feasibility*** and ***credibility*** of ***liquidating*** the institution under normal insolvency proceedings,
ii. in case that the resolution authority ascertains that winding up the institution is neither feasible nor credible, it ***selects the resolution strategy*** which considers appropriate in order to resolve the institution in an orderly manner without disrupting its operation, and
iii. lastly, the resolution authority assesses the ***feasibility and credibility of the preferred resolution strategy***.

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[39] *Ibid*, Article 15(3).

[40] *Ibid*, Article 15(1).

[41] *Ibid*, Article 15(2).

[42] **Commission Delegated Regulation 2016/1075**, Article. 23(1).

4.2.2.2.1 Assessment of the feasibility and credibility of liquidation under normal insolvency proceedings

When assessing the ***credibility of liquidation***, the resolution authority explores the likely impact of the liquidation of the institution on the financial system of any Member State or of the Union, with a view to ensuring the continuity of access to critical functions carried out by the institution and achieving the resolution objectives of **Article 31 BRRD**. For this purpose, the resolution authority must take account of the functions performed by the institution and assess if liquidation is likely to have a material adverse impact on any of the following:

- financial market functioning and in particular the impact on market confidence,
- financial market infrastructures,
- other financial institutions, and
- the real economy and in particular on the availability of critical financial services.

If the resolution authority determines that liquidation is credible, it subsequently assesses the ***feasibility of liquidation*** which is verified, provided that the following conditions are fulfilled:[43]

- the institution's systems are able to provide the information required by the relevant DGS for the purposes of compensating covered depositors in the amounts and timeframes provided in the DGSD, or where relevant in accordance with equivalent third country DGSs, including covered deposit balances, and
- the institution has the capability of supporting the DGS's operations, in particular by distinguishing between covered and non-covered balances on deposit accounts.

4.2.2.2.2 Identification of a resolution strategy

If the resolution authority concludes that the liquidation of the institution is neither credible nor feasible, it determines the resolution strategy that considers appropriate for the achievement of the resolution objectives taking into account:

- the structure and business model of the institution, and
- the resolution regimes applicable to the legal entities consisting of the banking group.

With regard to banking groups, the resolution authority must assess whether it would be more appropriate to apply:[44]

- a ***single point of entry*** strategy (hereinafter the '**SPE'**), or
- a ***multiple point of entry*** strategy (hereinafter the '**MPE**').

Taking account of the matters referred to in **Article 25(3)** of the **Commission Delegated Regulation 2016/1075**, the resolution authority must select the appropriate resolution strategy between the SPE and the MPE strategy.

[43] *Ibid*, Article 24(4).

[44] *Ibid*, Article 25(2).

The ***SPE strategy*** is defined as a resolution strategy involving the application of resolution powers by a single resolution authority at the level of a single parent undertaking or of a single institution subject to consolidated supervision.[45] This means that only the entity at the top of the banking group is resolved, since it is, for many reasons, inefficient and incredible to put into resolution the entities constituting the group, particularly in case they are established in many countries around the world. The SPE strategy contributes to resolving a failing group avoiding legal risks and the potential dislocation of systemic functions necessary to provide services.[46] The SPE strategy is more likely to be appropriate if a group operates in a highly integrated manner, including by having centralised liquidity management, treasury functions or IT and other critical shared services.[47]

On the contrary, the ***MPE strategy***, in accordance with **Article 2, point (6) of the Commission Delegated Regulation 2016/1075,** is a resolution strategy involving the exercise of resolution powers by two or more resolution authorities to regional of functional sub-groups or entities of a group. The MPE strategy is credible to apply to groups with few subsidiaries and focused on retail banking. In addition, it is more likely to be appropriate if a group's operations are divided into two or more clearly identifiable subgroups, each of which is to a significant extent independent (financially, legally or operationally) from other parts of the group and any other critical dependencies on other parts of the group are based on robust arrangements that ensure their continued operation in the event of resolution.[48]

The amount, composition and internal allocation of the MREL is highly linked to the resolution strategy chosen by the resolution authority. According to **Article 25(3), point (b) of the Commission Delegated Regulation 2016/1075**, the SPE strategy is more likely to be appropriate if sufficient externally issued eligible liabilities or liabilities expected to contribute to loss absorption and recapitalisation are issued by the top parent or group holding company. In contrast, **MPE strategy** is more likely to be appropriate if the group's eligible liabilities are issued by more than one entity or regional or functional sub-group in the group that would be resolved.

The qualification of the contractual bail-in instruments governed by third country law in the MREL (see below, in Section C, under 4) is critical to the determination of the resolution strategy, given the fact that the issuance of those instruments enables the resolution authority to implement effectively an MPE strategy avoiding legal constraints arising from the different insolvency rules applied in various jurisdictions, including third countries.

4.2.2.2.3 Feasibility and credibility assessment of a resolution strategy

The resolution authority must assess whether it is ***feasible to apply the selected resolution strategy*** both effectively and in an appropriate timeframe and identify potential impediments to the implementation of the selected resolution strategy. Within this context, the resolution authority must examine if there are:

- any impediments to the short-term stabilisation of the institution, and

[45] *Ibid* , Article 2, point (d).

[46] **Gracie (2015)**, p. 5.

[47] **Commission Delegated Regulation 2016/1075**, Article 25(3), point (d).

[48] *Ibid*, Article 25(3), point (d).

- any foreseeable impediments to a business reorganisation, as provided for in **Article 52 BRRD**, or likely to be required if the resolution strategy envisages all or part of the institution being restored to long-term viability.

Specifically, the resolution authority must examine certain aspects of the selected resolution strategy,[49] including issues concerning ***financial resources*** with regard to which the resolution authority must identify and quantify the amount of any liabilities, which are likely not to contribute to loss absorption or recapitalisation, considering at least the following factors:[50]

- maturity,
- subordination ranking,
- the types of holders of the instrument or the instrument's transferability,
- legal impediments to loss absorbency, such as lack of recognition of resolution tools under foreign law or existence of set-off rights,
- other factors creating risk that the liabilities will be exempted from absorbing losses in resolution, and
- the amount and issuing legal entities of qualifying eligible liabilities or other liabilities which would absorb losses.

Where the resolution authority determines, after consulting the supervisory authority, that there are substantive impediments to the resolvability of the institution concerned, it notifies in writing that determination to the institution, to the supervisory authority and to the resolution authorities of the jurisdictions in which significant branches of the relevant institution are located. As a first step, the institution must within a four-month period propose to the resolution authority measures in order to address or remove the identified impediments to resolvability.[51] Subsequently, if, according to the resolution authority, the proposed measures do not effectively reduce or remove the identified impediments, it requires the institution to take alternative measures provided for in **Article 17(5) BRRD**, which can be grouped under three categories:[52]

- ***structural measures*** associated with the organisational, legal and business structure of the institution,
- ***financial measures*** related to the institution's assets, liabilities and products, and
- ***information requirements***.

[49] For the purpose of assessing the feasibility of the preferred resolution strategy, the resolution authority must assess, except for financial resources of the strategy concerned, the following aspects of the resolution strategy:

- structure and operations of the institution concerned,
- information that the institution is capable to provide,
- cross-border issues, particularly concerning the cooperation of home-host authorities, and
- legal issues.

[50] **Commission Delegated Regulation 2016/1075**, Article 28, point (2).

[51] **BRRD**, Article 17(3).

[52] **EBA Guidelines (2014a)**, pp. 4-6.

The resolution authority has wide discretion on requiring the appropriate measures to be taken by the institution, including, *inter alia*:[53]

- to divest specific assets (***structural measure***),
- to move on changes on legal or operational structures of the institution, either directly or indirectly under its control, so as to reduce complexity and to ensure that critical functions may be legally and operationally separated from other functions through the application of the resolution tools (***structural measure***),
- to set up a parent financial holding company in a Member State or a Union parent financial holding company (***structural measure***),
- to issue eligible liabilities to meet the MREL (***financial measure***), and
- to take other steps to meet the MREL, including in particular to attempt to renegotiate any eligible liability, additional Tier 1 instrument, Tier 2 instrument it has issued, with a view to ensuring that any decision of the resolution authority to write down or convert that liability or instrument would be effected under the law of the jurisdiction governing that liability or instrument (***financial measure***).

After assessing the feasibility of the preferred resolution strategy, the resolution authority assesses its ***credibility***, considering the likely impact of the implementation of the resolution strategy on the financial systems of any Member State or of the Union. For this purpose, it is necessary the resolution authority to take account of the functions carried out by the institution and to assess whether the implementation of the resolution strategy is likely to have a substantial adverse impact on any of the following:

- financial market functioning and in particular the impact on market confidence,
- financial market infrastructures
- other financial institutions, and
- the real economy and in particular on the availability of financial services.

4.2.3 Setting the level of the recapitalisation amount

In case that the resolution authority concludes based on the resolvability assessment that the liquidation of the institution is not feasible and credible, it has to set a recapitalisation amount. The recapitalisation amount must be the sum of the following components:

i. the ***amount necessary in order for the institution to meet applicable capital requirements*** to comply with the conditions for authorisation after the resolution, and
ii. any ***additional amount necessary to maintain sufficient market confidence***, if the resolution authority deems it necessary.

Regarding the ***first component***, capital requirements must include the following:[54]

a) ***own funds requirements*** pursuant to **Articles 92** and **458 CRR**, which include:

- CET 1 capital ratio of **4.5%** of RWAs,
- Tier 1 capital ratio of **6%** of RWAs,

[53] **BRRD**, Article 17(5).

[54] **Commission Delegated Regulation 2016/1450**, Article 2(6).

- total capital ratio of **8%** of RWAs,

b) any ***additional own funds requirements*** imposed on the institution in the context of the ***Pillar II*** (Article 104(1), point (a) **CRD IV**),

c) the ***Basel I floor*** (Article 500 **CRR**), and

d) any applicable ***leverage ratio requirement***.

The ***additional amount required by the resolution authority in order to maintain sufficient market confidence*** must not exceed the combined buffer requirement applicable to the institution after the implementation of the resolution tools. Specifically, the additional amount required by the resolution authority may be lower than the combined buffer requirement if the resolution authority considers that a lower amount would be sufficient to sustain market confidence and ensure the continued provision of critical economic functions by the institution and access to funding, without recourse to extraordinary financial support other than contributions from resolution financing arrangements provided for **in Article 101(2) and Article 44(5) and (8) BRRD**.[55]

For the purpose of determining the additional amount of capital necessary to support market confidence, the following factors must be taken into account:

- the capital position of peer institutions, ,[56] and
- the capital resources in other entities of the banking group, which would credibly and feasibly be available to support market confidence in the institution following resolution, in the case that these entities:[57]
  - were subsidiaries of the banking group subject to a consolidated MREL at the pre-resolution phase, and continue to be after the implementation of the preferred resolution strategy, and
  - are not expected to maintain market confidence and access to funding on an individual basis following implementation of the preferred resolution strategy.

In addition, for the purpose of determining the recapitalisation amount, the resolution authority may decide, after consultation with the supervisory authority and taking into account the ***Supervisory Review and Evaluation Process*** (hereinafter the '**SREP**') ***assessment***, not to apply to the institution under resolution fully or partially the ***additional own funds requirement*** or ***buffer requirements*** applicable to it in the pre-resolution phase.[58]

If the assets, liabilities or business lines of the institution are to be split between more than one entity following implementation of the preferred resolution strategy, the aforementioned references to RWAs and capital requirements should be understood as the aggregate amounts across these entities.

In order to estimate the recapitalisation amount, the resolution authority must take into consideration the most recent reported values for the relevant RWAs or leverage ratio denominator, unless all the following factors apply:

- the resolution plan identifies, explains and quantifies any change in regulatory capital needs immediately as a result of resolution action, and

[55] *Ibid*, Article 2(8).

[56] *Ibid*, Article 2(8).

[57] *Ibid*, Article 2(10).

[58] *Ibid*, Article 2(10).

- the above-mentioned 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 financial support other than contributions from resolution financing arrangements pursuant to **Article 101(2) BRRD** and to the principles governing their use set out in **Article 44(5)** and **(8) BRRD**.

Where the changes are dependent on the actions of a purchaser of assets or business lines of the institution under resolution, or of third parties, the resolution authority must prepare a reasoned explanation to the benefit of the supervisory authority as to the feasibility and credibility of that change.[59]

4.3 Adjustment of loss absorption and recapitalisation amount based on institution's business model, funding model and risk profile

In the context of determining the MREL, the resolution authority must take into account information received from the supervisory authority, as part of the consultation provided for in **Article 45(6) BRRD**, a summary and an explanation of the SREP assessment carried out in accordance with ***EBA Guidelines on SREP***, and in particular:[60]

- a summary of the assessment of each of the business model, funding model and overall risk profile of the institution,
- a summary of the assessment of whether capital and liquidity held by an institution ensure sound coverage of the risks posed by the business model, funding model and overall risk profile of the institution,
- information on how risks and vulnerabilities arising from the business model, funding model and overall risk profile of the institution identified in the SREP are reflected, directly or indirectly, in the additional own funds requirements in the context of the Pillar II, and
- information on other prudential requirements applied to the institution to address risks and vulnerabilities arising from the business model, funding model and overall risk profile of the institution identified in the SREP.

The resolution authority must take into consideration the above-mentioned information, if it deems relevant for the purpose of making adjustments to the default loss absorption amount and recapitalisation amount, as referred above in 4.1 and 4.2 respectively.[61] The resolution authority must provide the supervisory authority with a reasoned explanation of how this information has been taken into account in any such adjustment.

In case of entities which are subsidiaries of a group subject to a consolidated MREL, the resolution authority may exclude from its assessment of the loss absorption and recapitalisation amount any buffer set only on a consolidated basis.[62]

Where the determination of the countercyclical buffer rate is responsibility of a designated authority other than the supervisory authority of the Member State

[59] *Ibid*, Article 2(4).

[60] *Ibid*, Article 4(1).

[61] *Ibid*, Article 4(2).

[62] *Ibid*, Article 4(4).

concerned, the resolution authority may request additional information from the relevant designated authority.[63]

4.4 The 'no creditor worse off principle' adjustment of the MREL

4.4.1 The 'no creditor worse off principle'

The BRRD establishes safeguards in order to ensure that shareholders and creditors, in case of partial transfers and application of the bail-in tool, do not incur greater losses than they would have incurred in case of winding up the institution under normal insolvency proceedings. It is about the '***no creditor worse off principle'***, one of the general principles governing resolution, provided for in **Article 34(1), point (g) BRRD** and specified in **Articles 73 and 75 BRRD**.

According to **Article 73 BRRD**, where one or more resolution tools have been applied:

a) except where the bail-in tool is applied (point b), where the resolution authority transfers only parts of the rights, assets and liabilities of the institution under resolution, the shareholders and the creditors whose claims have not been transferred, receive in satisfaction of their claims at least as much as what they would have received if the institution under resolution had been wound up under normal insolvency proceedings at the time when the decision for putting the institution into resolution was taken,

b) where the resolution authority applies the bail-in tool, the shareholders and creditors whose claims have been written down or converted into equity do not incur greater losses than they would have incurred if the institution under resolution had been wound up under normal insolvency proceedings immediately at the time when the decision for putting the institution into resolution was taken.

To assess whether shareholders and creditors of an institution put in resolution received treatment no worse than they would have received if the institution had been liquidated under normal insolvency proceedings, it is necessary a post-resolution valuation to be carried out.[64] According to **Article 75 BRRD**, where the post-resolution valuation determines that any shareholder, creditor or the home DGS has incurred greater losses than they would have incurred under liquidation, the relevant resolution financing arrangement is liable to pay compensation to the affected persons.

Specifically, pursuant to **Article 74(1) BRRD**, an independent person must carry out a valuation as soon as possible after the resolution action, which will be distinct from the pre-resolution valuation carried out according to **Article 36 BRRD**.

4.4.2 The MREL adjustment as a result of the 'no creditor worse off principle'

For the purpose of determining the MREL, the resolution authority is obliged to identify any liabilities which is excluded from bail-in under **Article 44(2) BRRD** or are reasonable likely to be fully or partially excluded from bail-in under **Article 44(3) BRRD** or transferred to a recipient in full using other resolution tools based on the resolution plan. Then, the resolution authority must ensure that the MREL is sufficient for purposes of loss absorption (loss absorption amount) and recapitalisation

[63] *Ibid*, Article 4(5).

[64] For more details on post-resolution valuation, see **Article 74 BRRD**.

(recapitalisation amount), without writing down or converting into equity the aforementioned liabilities that are likely to be fully or partially excluded from bail-in.[65]

Following the identification of the liabilities likely to be excluded from bail-in, the resolution authority must determine:

- if these liabilities rank equally or junior in the insolvency creditor hierarchy to any class of liability qualifying for inclusion in the MREL, and
- if the amount of these liabilities exceeds 10% of any class of liabilities, which ranks equally in insolvency.

In case that the identified as likely to be excluded liabilities exceed 10% of any class of liabilities which ranks equal in insolvency, the resolution authority must assess if the other instruments qualifying for the MREL are adequate to satisfy loss absorption and recapitalisation, without breaching the creditor safeguards provided for in **Article 73 BRRD**.[66]

The resolution authority must document any assumptions, valuations or other information used to determine that the MREL meets the aforementioned conditions.[67]

Taking into consideration the above-mentioned, it can be assumed that it is likely for legal and operational problems to arise if uncovered deposits (i.e. deposits exceeding 100.000 euros), though bail-inable, are excluded from the MREL because of the fulfillment of the criterion referred to in **Article 44(3), point (c) BRRD**. That criterion states that *"the exclusion is strictly necessary and proportionate to avoid giving rise to contagion, in particular as regards eligible deposits held by natural persons and micro, small and medium-sized enterprises, which would severely disrupt the functioning of financial markets, including of financial market infrastructures, in a manner that could cause a serious disturbance to the economy of a Member State or of the Union"*.

For instance, if senior unsecured debt exceeds 10% of other senior unsecured liabilities (e.g. corporate deposits over 100.000 euros, interbank deposits, derivatives), the resolution authority may not count senior unsecured debt towards the MREL and require the institution to satisfy the MREL by taking measures like those described below, under Section D.

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[65] **Commission Delegated Regulation 2016/1450**, Article 3(2).

[66] *Ibid*, Article 3(3).

[67] *Ibid*, Article 3(4).

Liabilities excluded from bail-in pursuant to Article 44(2) BRRD

According to **Article 44(2) BRRD**, the resolution authority must not exercise the write-down and conversion powers to the following liabilities whether they are governed by the law of a Member State or of a third country:

a) covered deposits,

b) secured liabilities including covered bonds and liabilities in the form of financial instruments used for hedging purposes which form an integral part of the cover pool and which according to national law are secured in a way similar to covered bonds,

c) any liability that arises by virtue of the holding by the institution or entity referred to in **Article 1(1), point (b), (c) or (d)) BRRD** of client assets or client money including client assets or client money held on behalf of UCITS as defined in **Article 1(2) of Directive 2009/65/EC** or of AIFs as defined in **Article 4(1)(point a) of Directive 2011/61/EU**, provided that such a client is protected under the applicable insolvency law,

d) any liability that arises by virtue of a fiduciary relationship between the institution or entity referred to in **Article 1(1), points (b), (c) or (d) BRRD** (as fiduciary) and another person (as beneficiary) provided that such a beneficiary is protected under the applicable insolvency or civil law,

e) liabilities to institutions, excluding entities that are part of the same group, with an original maturity of less than seven days,

f) liabilities with a remaining maturity of less than seven days, owed to systems or operators of systems designated according to **Directive 98/26/EC** or their participants and arising from the participation in such a system,

g) a liability to any one of the following:

   i. an employee, in relation to accrued salary, pension benefits or other fixed remuneration, except for the variable component of remuneration that is not regulated by a collective bargaining agreement,

   ii. a commercial or trade creditor arising from the provision to the institution of goods or services that are critical to the daily functioning of its operations, including IT services, utilities and the rental, servicing and upkeep of premises,

   iii. tax and social security authorities, provided that those liabilities are preferred under the applicable law, and

   iv. deposit guarantee schemes arising from contributions due in accordance with **Directive 2014/49/EU**.

Point (g)(i) of the first subparagraph must not apply to the variable component of the remuneration of material risk takers as identified in **Article 92(2) CRD IV**.

Liabilities excluded from bail-in on discretion of the resolution authority

According to **Article 44(3) BRRD**, the resolution authority may decide to fully or partially exclude certain liabilities from the application of the bail-in tool, where:

- it is not possible to bail-in that liability within a reasonable time notwithstanding the good faith efforts of the resolution authority,
- the exclusion is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines in a manner that maintains the ability of the institution under resolution to continue key operations, services and transactions,
- the exclusion is strictly necessary and proportionate to avoid giving rise to widespread contagion, in particular as regards eligible deposits held by natural persons and micro, small and medium sized enterprises, which would severely disrupt the functioning of financial markets, including of financial market infrastructures, in a manner that could cause a serious disturbance to the economy of a Member State or of the Union, or
- the application of the bail-in tool to those liabilities would cause a destruction in value such that the losses borne by other creditors would be higher than if those liabilities were excluded from bail-in.

Where the resolution authority decides to exclude or partially exclude an eligible liability or class of eligible liabilities because it is fulfilled one of the above-mentioned criteria, the level of bail-in applied to other eligible liabilities may be increased to take account of such exclusions, provided that the level of write-down and conversion applied to other eligible liabilities complies with the 'no creditor worse off principle' (**Article 34(1), point (g) BRRD**).

4.5 The MREL adjustment because of the possible contribution of the DGS

4.5.1 Role of the DGSs in resolution

Until the adoption of the BRRD and the transposition of its provisions into national law of Member States, DGSs were competent only for paying compensation to covered depositors in case of liquidation of insolvent institutions under normal insolvency proceedings in accordance with the **Directive 94/19/EC on deposit guarantee schemes**, as amended with the **Directive 2009/14/EC**.

The role of DGSs changed significantly with the adoption of the BRRD and the DGSD, given the fact that both legislative acts assign to DGSs the task to contribute to resolution of failing institutions.[68] Specifically, pursuant to **Article 11(2) DGSD**, the financial means of a DGS must be used in order to finance the resolution of institutions in accordance with the provisions of **Article 109 BRRD**. According to this Article, where the resolution authority takes action and provided that that action ensures that depositors continue to have access to their deposits, the DGS to which the institution is affiliated is liable for:

- ***when the bail-in tool is applied***, the amount by which covered deposits would have been written down in order to absorb the losses so as to ensure that the net

[68] For a detailed overview of the DGSD, see **Gortsos (2014a)**.

asset value of the institution under resolution is equal to zero, had covered deposits included within the scope of bail-in and been written down to the same extent as creditors with the same level of priority under the national law governing normal insolvency proceedings, or

- ***when one or more resolution tools other than the bail-in tool is applied***, the amount of losses that covered depositors would have suffered, had covered depositors suffered losses in proportion to the losses suffered by creditors with the same level of priority under the national law governing normal insolvency proceedings.

Consequently, the DGS contributes to the recapitalisation of the institution under resolution, only if it has negative net asset value, and in no case is it permitted to make contribution to recapitalising an institution which has positive net asset value.[69]

In all cases, the liability of the DGS must not be greater than:[70]

- the amount of losses that it would have incurred had the institution been wound up under normal insolvency proceedings, or
- the amount equal to 50% of the DGS's target level.

4.5.2 Downwards adjustment of the MREL because of the DGS's contribution to resolution

The resolution authority may reduce the MREL by the amount that the DGS of the home country of the institution concerned is expected to contribute to the financing of the preferred resolution strategy pursuant to **Article 109 BRRD**. The size of any such reduction must be based on a credible assessment of the potential contribution of the DGS and must at least:[71]

- be less than a prudent estimate of the potential losses which the DGS would have had to bear, had the institution been wound up under normal insolvency proceedings, taking into account the priority ranking of the DGS pursuant to **Article 108 of the BRRD**,
- be less than 50% of its target level or any other alternative percentage set by the national authorities,
- take account of the overall risk of exhausting the available financial means of the DGS due to contributing to multiple institution failures or resolutions, and
- be consistent with any other relevant provisions in national law and the duties and responsibilities of the authority responsible of the DGS.

Consequently, the reduction of the MREL due to the possible contribution of the DGS ranges:

- **from zero**, if the resolution authority considers that there is high risk of exhaustion of the available financial means of the DGS in case of a systemic crisis with multiple institution failures or resolutions,
- **to maximum of 50% of the DGS's target level.**

[69] **BRRD**, Article 109(1).

[70] *Ibid*, Article 109(1) and (5).

[71] **Commission Delegated Regulation 2016/1450**, Article 6(2).

The resolution authority must, after consultation with the designated authority for the DGS, document its approach concerning the assessment of the overall risk of exhausting the available financial means of the DGS and reduce the MREL, only if this risk is not excessive.[72]

4.6 The 8% of total liabilities and own funds floor constraint in respect of G-SIIs and O-SIIs

4.6.1 Contribution of the resolution financing arrangements to resolution

According to **Article 100 BRRD**, Member States are obliged to establish one or more financing arrangements for the purpose of effective application by the resolution authority of the resolution tools and powers provided for in BRRD. The national resolution financing arrangements of the participating in the EBU Member States set up under the BRRD were replaced by the SRF since 1 January 2016.

With regard to the Member States which will not participate in the EBU, **Article 102(1) BRRD** determines that by 31st December 2024, the target level of the national resolution funds must amount at least to 1% of covered deposits of institutions incorporated in the jurisdiction concerned. With regard to the SRF, its target level must reach at least 1% of covered deposits of the institutions located in the participating in the EBU Member States by 31 December 2023.[73]

The available financial means of the resolution financing arrangements (national or SRF), gathered from the contributions raised by the institutions authorised in the respective territories, can be used for many purposes in the context of resolution, as specified in **Article 101(1) BRRD**.[74]

As mentioned above (under 4.4.1), the resolution authority may, in exceptional circumstances, decide to exclude or partially exclude an eligible liability or class of eligible liabilities from the application of the write-down and conversion powers, where it deems that certain conditions are satisfied. In this case, with regard to the losses that would have been borne by those liabilities and have not been passed on fully to other creditors, the resolution financing arrangement may make a contribution to the institution under resolution to do one or both of the following:[75]

a) cover any losses which have not been absorbed by eligible liabilities and restore the net asset value of the institution under resolution to zero in accordance with **Article 46(1), point (a) BRRD**,

b) purchase shares or other instruments of ownership or capital instruments in the institution under resolution in order to recapitalise the institution in accordance with **Article 46(1), point (b) BRRD**.

According to **Article 44(5) BRRD**, the resolution financing arrangement may make a contribution, provided that both following conditions are fulfilled:

a) shareholders and holders of other relevant capital instruments and eligible liabilities have contributed, through write-down and conversion into equity, to

[72] *Ibid*, Article 6(3).

[73] **SRMR**, Article 69(1).

[74] For more details on ex-ante contributions on resolution financing arrangements, see **Commission Delegated Regulation (EU) 2015/63** of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to ex ante contributions to resolution financing arrangements.

[75] **BRRD**, Article 44(4).

loss absorption and recapitalisation of the institution under resolution with an amount **not less than 8 %** of its total liabilities and own funds, measured at the time of resolution action in accordance with the pre–resolution valuation carried out in accordance with **Article 36 BRRD**, **and**

b) the contribution of the resolution financing arrangement does not exceed 5% of the total liabilities and own funds of the institution under resolution, measured at the time of resolution action in accordance with the pre-resolution valuation carried out in accordance with **Article 36 BRRD**.

4.6.2 Size and systemic risk

The resolution authority must identify institutions whose failure is reasonably likely to pose systemic risk and, given the potential negative consequences to arise from their failure, ensure that external funding from the resolution financing arrangements is available, if needed. Therefore, **Article 5 of the Commission Delegated Regulation 2016/1450,** lays down an additional parameter for the determination of the MREL in respect of:

- G-SIIs,
- O-SIIs, and
- any other institutions deemed by the supervisory authority or the resolution authority that pose a systemic risk in case of failure.

With regard to the aforementioned institutions, the resolution authority must give due account to the aforementioned requirements set out in **Article 44 BRRD**.[76] Where a joint decision on the MREL by the resolution college is required pursuant to **Article 45 BRRD** for systemically important institutions, any downward adjustment to estimate capital instruments after resolution (i.e. recapitalisation amount) must be documented and explained in the information provided to the members of the resolution college.[77]

5. Stylised examples

Taking into account the aforementioned analysis, we conclude that the level of the MREL an institution must comply with is the sum of the following two components:

- the ***loss absorption amount***, and
- the ***recapitalisation amount***,

adapted by the following factors:

- the '***no creditor worse off principle' adjustment***, and
- the ***downward adjustment because of the possible contribution of the DGS***.

For illustrative purposes find below two stylised examples which demonstrate the methodology for the MREL calculation. These stylised examples provide clarity on the significance, for the purposes of setting the level of the MREL, of the resolution tool provided for in the resolution plan to be applied in an institution, given that the application of the bail-in tool may not imply any reduction in the post-resolution RWAs of the relative institution compared to its pre-resolution RWAs, which is detrimental for determining the level of the recapitalisation amount.

[76] **Commission Delegated Regulation 2016/1450**, Article 5(1).

[77] *Ibid*, Article 5(2).

Stylised example of setting the MREL for Bank A

Bank A is a medium-sized institution which has to comply with the following requirements:

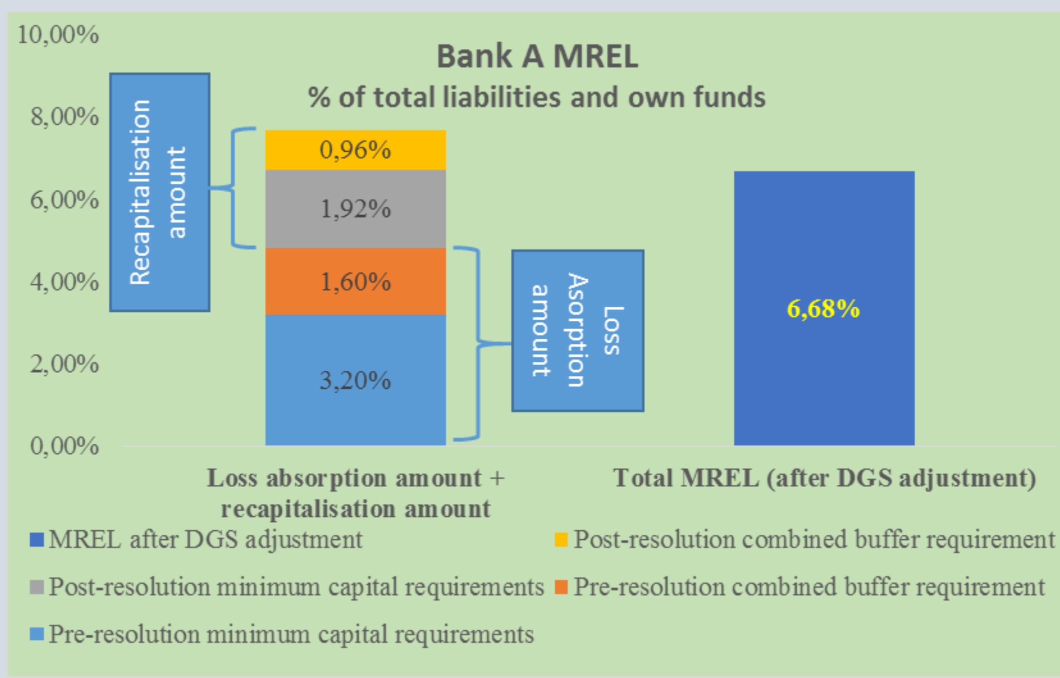
- ***minimum capital requirements*** amounting to **8%** of RWAs, and
- a **combined buffer requirement** equal to **4%** of RWAs, consisting of
    - a ***capital conservation buffer*** of **2.5%** of RWAs, and
    - a ***institution-specific countercyclical buffer*** amounting to **1.5%** of RWAs.

Bank A RWAs are 40% of total liabilities and own funds. Consequently, the ***loss absorption amount*** equals to **4,8%** of total liabilities and own funds (i.e. 8%+4%=12%*40%=**4,8%**).

The resolution plan provides that the only feasible and credible resolution strategy is the application of the ***bridge bank tool***. In particular, assets related to critical functions and liabilities (mainly covered and uncovered deposits) would be transferred to a bridge bank and the remaining assets and liabilities would be liquidated. The planned bridge bank would account for 60% of the Bank A RWAs. After the resolution, the institution would have to meet the minimum capital requirements (8%) and the combined buffer requirement (4%) applicable before resolution in order to maintain sufficient market confidence. Therefore, the ***recapitalisation amount*** equals to **2.88%** of total liabilities and own funds (i.e. 8%+4%=12%*60% (post-resolution RWAs)*40%=**2,88%.**

Lastly, the resolution authority expects the relevant DGS to contribute to financing resolution costs by an amount equal to 50% of its target level, which amounts to **1%** of institution's total liabilities and own funds.

Taking into account the loss absorption amount of **4.8%**, the recapitalisation amount of **2.88%** and the MREL adjustment because of the DGS contribution of **1%**, the institution must meet a total MREL of **6.68%** of total liabilities and own funds.



Stylised example of setting the MREL for Bank B

Bank B is a domestically important institution which has to comply with the following requirements:

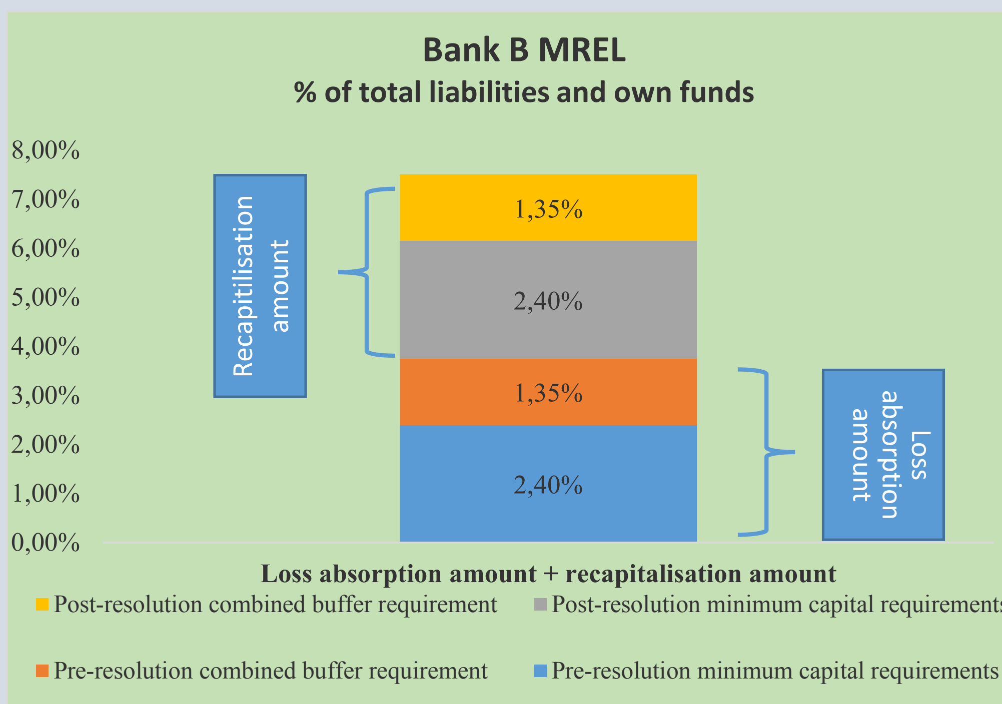
- ***minimum capital requirements*** amounting to **8%** of RWAs, and
- a ***combined buffer requirement*** equal to **4,5%** of RWAs, consisting of
  - a ***capital conservation buffer*** of **2.5%** of RWAs, and
  - a ***O-SII buffer*** of **2%** of RWAs.

Bank B RWAs are 30% of total liabilities and own funds. Consequently, the ***loss absorption amount*** equals to **3,75%** of total liabilities and own funds (i.e. 8%+2,5%+2%=12,5%*30%=**3,75%**).

The resolution plan provides that the only feasible and credible resolution strategy is the application of the ***bail-in tool***, and so resolution will not result in immediate reduction of the RWAs. After the resolution, the institution would have to meet the minimum capital requirements (8%) necessary to comply with the conditions for authorisation and the combined buffer requirement (4,5%) applicable before resolution in order to maintain sufficient market confidence. Therefore, the resolution authority sets the ***recapitalisation amount*** equal to loss absorption amount (**3,75%** of total liabilities and own funds**).**

In the resolution plan, it is provided that the relevant DGS will not contribute to financing resolution costs, since it is anticipated that there is significant risk of exhausting the available financial means of the DGS due to contributing to multiple institutions failures.

Summing the loss absorption amount of ***3.75%*** and the ***recapitalisation amount*** of ***3.75%***, this gives a ***total MREL*** of ***7.5%*** of total liabilities and own funds.



C. Other provisions on the MREL

1. Transitional period and post resolution arrangements

The obligation of institutions to comply with the MREL is a heavy burden for them, since they are committed concurrently to meet -until 2019- the rigorous capital requirements introduced by the Basel III framework in respect of both quantity and quality of own funds. The additional obligation to meet the MREL, which can be met mainly by issuing subordinated debt and senior bonds, implies increased cost of funding for institutions that is plausibly estimated to affect their capability to grant credit in order to finance the economy.

Therefore, in order to give institutions adequate time to meet the MREL without significant negative implications for their own activities and their role for the economy, **Article 8 of the Commission Delegated Regulation 2016/1450** provides resolution authorities with the discretion to require institutions to satisfy gradually the MREL by setting a transitional period, which is as short as possible. For each twelve (12) months during the transitional period, the resolution authority must communicate to the institution concerned a planned MREL. In any case, the resolution authority can revise the transitional period or any planned MREL.[78]

2. Determination of the MREL on a consolidated basis

Institutions have to meet at all times the MREL on a solo basis, whereas the resolution authority may decide, after consulting the supervisory authority, to apply the MREL also to the other entities included in the scope of application of the BRRD, except for branches of institutions established outside the Union.[79]

In addition, Union parent undertakings must comply with the MREL on a consolidated basis. In this context, the group-level resolution authority must determine the MREL at consolidated level, after consulting the consolidating supervisor, at least based on:

- the criteria for determining the level of the MREL applied to any institution, and
- whether the third-country subsidiaries of the banking group are to be resolved separately according to the resolution plan.

The group-level resolution authority and the resolution authorities responsible for the subsidiaries on an individual basis must do everything within their power to reach a joint decision at the level of the MREL on the consolidated basis. The joint decision must be fully reasoned and be provided to the Union parent undertaking by the group-level resolution authority.[80]

If a joint decision is not reached within four months, the group-level resolution authority takes a decision on the MREL at a consolidated level, after duly taking into consideration the assessment of subsidiaries carried out by the relevant resolution authorities. If, at the end of the four-month period, any of the resolution authorities concerned has referred the matter to the EBA in accordance with **Article 19 EBA Regulation**, the group-level resolution authority must defer its decision and await any decision the EBA may take according to which it may require from them to take specific action or to refrain from action in order to settle the matter, with binding

[78] *Ibid*, Article 8(3).

[79] **BRRD**, Article 45(7).

[80] *Ibid*, Article 45(9).

effects for the resolution authorities concerned. In this case, the group-level resolution authority must take a decision in accordance with the decision of the EBA, which has to be taken within one month. The matter must not be referred to the EBA after the end of the four-month period or after a joint decision has been reached. In the absence of an EBA decision within the one-month period, the decision of the group-level resolution authority applies.

Both the joint decision and the decision taken by the group-level resolution authority in case of not reaching a joint decision is binding for the resolution authorities in the Member States concerned. Both will have to be reviewed and, where relevant, updated on a regular basis.

According to **Article 45(10) BRRD**, the resolution authorities are competent for the determination of the MREL to the group's subsidiaries on an individual basis having regard to:[81]

- the assessment criteria referred to in **Section B, under 4**, and
- the consolidated requirement that has been set for the group on a consolidated basis.

The determination of the level of the MREL applied to each subsidiary of the group is made pursuant to the joint decision procedure described above. Specifically, the group-level resolution authority and the resolution authorities of the Member States, where the subsidiaries of the group are established, must do everything within their power to reach a joint decision on the level of the MREL applied to each subsidiary on a solo basis. The joint decision must be fully reasoned and be provided to the subsidiaries and to the Union parent institution by the resolution authority of the subsidiaries and by the group-level resolution authority, respectively.

If a joint decision is not reached within four months, the resolution authorities of the subsidiaries must take a decision duly considering the views and reservations expressed by the group-level resolution authority. If, at the end of the four-month period, the group-level resolution authority has referred the matter to the EBA in accordance with **Article 19 EBA Regulation**, the resolution authorities for the subsidiaries on an individual basis must defer their decisions and await any decision the EBA may take according to which it may require from them to take specific action or to refrain from action in order to settle the matter, with binding effects for the resolution authorities concerned. In this case, the resolution authorities of the subsidiaries must take their decisions in accordance with the decision of the EBA, which has to be taken within one month. The matter must not be referred to the EBA:

- after the end of the four-month period,
- after a joint decision has been reached, or
- by the group-level resolution authority, where the level set by the resolution authority of the subsidiary is within one percentage point of the MREL set at the consolidated level.

In the absence of an EBA decision within the one-month period, the decisions of the resolution authorities of the subsidiaries apply. The joint decision and any decisions taken by the resolution authorities of the subsidiaries in the absence of a joint decision:

- are binding for the resolution authorities concerned, and
- must be reviewed and where relevant updated on a regular basis.

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[81] *Ibid*, Article 45(10).

The procedure concerning the determination of the MREL at consolidated, parent and each subsidiary level is specified in **Articles 86-96** of the **Commission Delegated Regulation 2016/1075**, which contains provisions both for ***joint decision process*** and for ***process in the absence of joint decision***. Specifically, it includes technical provisions on:

- planning of the joint decision on the MREL (*Article 67*),
- proposal at consolidated and Union parent undertaking level (*Article 87*),
- proposal at subsidiary level (A*rticle 88*),
- dialogue on the proposed MREL (*Article 89*),
- drafting the joint decision on the MREL (A*rticle 90*),
- reaching the joint decision on the MREL (*Article 91*),
- communication of the joint decision on the MREL (*Article 92*),
- monitoring the application of the joint decision on the MREL (A*rticle 93*),
- joint decisions taken at each subsidiary level in the absence of a joint decision at consolidated level (*Article 94*),
- elements of communication of individual decisions (A*rticle 95)*, and
- communication of individual decisions in the absence of joint decision (*Article 96*).

3. Waiver of the application of the MREL

The group-level resolution authority may fully waive the application of the MREL to a Union parent institution on a solo basis, provided that:

- the Union parent institution complies on a consolidated basis with the MREL, and
- the supervisory authority of the Union parent institution has fully waived the application of individual capital requirements to the institution in accordance with the **Article 7(3) CRR**.

With regard to a subsidiary, the resolution authority concerned, may fully waive the MREL to that subsidiary on a solo basis, where:

- both the subsidiary and its parent undertaking are subject to authorisation and supervision by the same Member State,
- the subsidiary is included in the consolidated supervision of the institution, which is the parent undertaking,
- the highest level group institution in the Member State of the subsidiary, where different to the Union parent institution, complies on a sub-consolidated basis with the MREL,
- 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 undertaking,
- either the parent undertaking satisfies the supervisory authority regarding the prudent management of the subsidiary and has declared, with the consent of the supervisory authority, that it guarantees the commitments entered into by the subsidiary or the risks in the subsidiary are of no significance,

- the risk evaluation, measurement and control procedures of the parent undertaking cover the subsidiary,
- the parent undertaking holds more than 50 % of the voting rights attached to shares in the capital of the subsidiary or has the right to appoint or remove a majority of the members of the management body of the subsidiary, and
- the supervisory authority of the subsidiary has fully waived the application of individual capital requirements to the subsidiary under **Article 7(1) CRR**.

4. The role of contractual bail-in instruments in the MREL

4.1 Contractual recognition of bail-in

The transposition of the BRRD into the national law of the Member States implies that liabilities of institutions governed by the law of a Member State are subject to write-down and conversion powers assigned to resolution authorities. However, this does not apply to liabilities governed by the law of a third country, which means that the application of the write-down and conversion powers by the resolution authority of a Member State is possible to lead a third country court not to recognise the effect of the resolution decision concerned.

For this reason, **Article 55(1) BRRD** requires institutions which issue liabilities governed by the law of a third country to include in relevant agreements a contractual term by which the creditor or party to the agreement creating the liability recognises that it may be subject to the write-down and conversion powers and agrees to be bound by any reduction of the principal or outstanding amount due, conversion or cancellation that is effected by the exercise of those powers, provided that these liabilities are:

- not excluded under **Article 44(2) BRRD**,
- not eligible deposits of natural persons and micro, small and medium-sized enterprises exceeding coverage level (i.e. 100.000 euros per depositor per institution),
- governed by the law of a third country, and
- issued or entered into force after a Member State started to apply the bail-in provisions of the BRRD (by latest as of 1 January 2016).

However, the obligation of **Article 55(1) BRRD** related to contractual recognition of bail-in does not apply where the resolution authority determines that the liabilities or instruments satisfying the aforementioned criteria are subject to write-down and conversion powers by the resolution authority of a Member State pursuant to the law of a third country or to a binding agreement concluded with that third country.[82]

If the aforementioned terms are not included in the liabilities of an institution, this does not prevent the resolution authority from exercising the write-down and conversion powers with regard to these liabilities.[83]

4.2 Counting contractual bail-in instruments towards the MREL

In order to qualify for inclusion in the MREL, **Article 45(5) BRRD** provides that if a liability is governed by the law of a third country, the resolution authority may require

[82] *Ibid*, Article 55(1), second subparagraph.

[83] *Ibid*, Article 55(2).

the institution to demonstrate that any decision taken by the resolution authority in relation to writing down or converting that liability will be effective under the law of the third country, having regard to:

- the terms of the contract governing the liability ('contractual bail-in instrument'), and
- international agreements on the recognition of resolution proceedings and other relevant matters.

The resolution authority must not count towards the MREL a liability, if it considers that a resolution decision exercising write-down and conversion power would not be effective under the law of the third country.[84]

According to **Article 45(13) BRRD**, the resolution authority may allow an institution to meet partially the MREL at consolidated or individual level through contractual bail-in instruments. In order to count a contractual bail-in instrument towards the MREL, the following conditions must be satisfied:[85]

- the instrument contains a contractual term providing that, where the resolution authority decides to apply the bail-in tool to that institution, the instrument must be written down or converted to the extent required before other eligible liabilities are written down or converted, and
- the instrument is subject to a binding subordination agreement, undertaking or provision under which in the event of normal insolvency proceedings, it ranks below other eligible liabilities and cannot be repaid until other eligible liabilities outstanding at the time have been settled.

5. Cooperation between resolution authorities and supervisory authorities

Pursuant to **Article 45(15) BRRD**, resolution authorities, in coordination with supervisory authorities, must require and verify that institutions meet the MREL and where relevant the requirement in respect of the contractual bail-in instruments, and must take any decision in accordance with the provisions of **Article 45 BRRD** in parallel with the development and maintenance of resolution plans. Resolution authorities, in coordination with supervisory authorities, must inform the EBA of the MREL, and where relevant, of the contractual bail-in instruments that have been set for each institution under their jurisdiction.[86]

6. EBA report to the Commission

By 31 October 2016 the EBA must submit a report to the Commission, which will cover at least the period from 2 July 2014 until 30 June 2016, on at least the following aspects of the MREL:[87]

a) how the MREL has been implemented at national level, and in particular whether there have been divergences in the levels set for comparable institutions across Member States,

[84] *Ibid*, Article 45(5).

[85] *Ibid*, Article 45(14).

[86] *Ibid*, Article 45(16).

[87] *Ibid*, Article 45(19).

b) how the power to require institutions to meet the MREL through contractual bail-in instruments has been applied across Member States and whether there have been divergences in those approaches,

c) the identification of business models that reflect the overall risk profiles of the institution,

d) the appropriate level of the MREL for each of the business models identified under point (c),

e) whether a range for the level of the MREL of each business model should be established,

f) the appropriate transitional period for institutions to achieve compliance with any harmonised minimum levels prescribed,

g) whether the MREL is 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,

h) whether any changes to the calculation methodology provided for are necessary to ensure that the MREL can be used as an appropriate indicator of an institution's loss-absorbing capacity,

i) whether it is appropriate to base the MREL on total liabilities and own funds and in particular whether it is more appropriate to use the institution's RWAs as a denominator for the MREL,

j) whether the approach to the application of the MREL to groups is appropriate, and in particular whether that approach adequately ensures that loss absorbing capacity in the group is located in, or accessible to, the entities where losses might arise,

k) whether the conditions for waivers from the MREL are appropriate, and in particular whether such waivers should be available for subsidiaries on a cross-border basis,

l) whether it is appropriate that resolution authorities may require that the MREL be met through contractual bail-in instruments, and whether further harmonisation of the approach to contractual bail-in instruments is appropriate,

m) whether the requirements for contractual bail-in instruments are appropriate, and

n) whether it is appropriate for institutions and groups to be required to disclose their MREL, or their level of own funds and eligible liabilities, and if so, the frequency and format of such disclosure.

The EBA report must take account of at least the following:

a) the impact of the MREL, and any proposed harmonised levels of the MREL 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,

iii. the profitability of institutions, in particular their cost of funding,

iv. the migration of exposures to entities which are not subject to prudential supervision,

v. financial innovation,

vi. the prevalence of contractual bail-in instruments, and the nature and marketability of such instruments,

vii. the risk-taking behaviour of institutions,

viii. the level of asset encumbrance of institutions,

ix. the actions taken by institutions to comply with minimum requirements, and in particular the extent to which minimum requirements have been met by asset deleveraging, long-term debt issuance and capital raising,

x. the level of lending by credit institutions, with a particular focus on lending to micro, small and medium-sized, enterprises, local authorities, regional governments and public sector entities and on trade financing, including, lending under official export credit insurance schemes,

b) the interaction of the MREL with the own funds requirements, leverage ratio and the liquidity requirements laid down in CRR and in CRD IV,

c) the capacity of institutions to independently raise capital or funding from markets in order to meet any proposed harmonised minimum requirements, and

d) consistency with the minimum requirements relating to any international standards developed by international fora.

7. Commission legislative proposal on the harmonised application of the MREL across Member States

Pursuant to **Article 45(18) BRRD**, based on the results of the above-mentioned report that the EBA is obliged to submit to the Commission, the latter must, if appropriate, submit by 31 December 2016 to the European Parliament and the Council a legislative proposal on the harmonised application of the MREL. That legislative proposal must include, where appropriate, arrangements on:

- the introduction of an appropriate number of minimum levels of the MREL, taking account of the different business models of institutions and groups
- any appropriate adjustments to the parameters of the MREL, and
- if necessary, appropriate amendments to the application of the MREL to groups.

8. Impact assessment carried out by the EBA

8.1 Estimation of the MREL ratio based on impact of exclusion of certain liabilities

In the context of drafting regulatory technical standards, the EBA has the obligation to analyse the potential costs and benefits of the proposed provisions pursuant to **Article 10(1) EBA Regulation** and to carry out an impact assessment. Compliant with this task, the EBA performed an analysis based on a ***Quantitative Impact Study*** (hereinafter the '**QIS**') using data as at end 2014. The sample of the analysis consists of 64 institutions, including 14 G-SIIs, across 13 Member States. Due to data availability, only preliminary analyses are included in the EBA impact assessment.

As mentioned above, the resolution authority may exclude fully or partially a liability or a class of liabilities due to a number of factors related to:[88]

- maturity,
- subordination ranking,
- identity of the holders of liabilities,
- legal impediments (e.g. existence of set-off rights), and
- other factors, such as risk of needing to compensate creditors for breaches of safeguards of property rights or their role in performing critical functions.

Taking into consideration the aforementioned factors, the EBA assumes that:[89]

- the instruments least likely to be excluded from write-down and conversion are ***equity, own funds instruments*** and ***other subordinated debt***, cumulatively equal to ***6%*** of total liabilities and own funds of the sample,
- ***senior unsecured bonds with a residual maturity of more than one (1) year*** are at a greater risk of exclusion from loss absorption or recapitalisation, since holders would have made high recoveries in insolvency (for instance, because they rank *pari passu* to large amount of liabilities not subject to resolution, such as uncovered corporate deposits). The estimated share of these liabilities amount to **6.8%** of total liabilities and own funds of the sample,
- ***senior unsecured instruments other than bonds***, especially ***uncovered deposits with residual maturity of more than one year***, though eligible to qualify for inclusion in the MREL, may be excluded from scope of bail-in for the same reasons as senior unsecured bonds and because they are essential to the provision of critical functions. The EBA estimates that the share of these liabilities amounts to **2.8%** of total liabilities and own funds of the sample.

Consequently, given that only own funds instruments and other subordinated debt amount to **6%** of total liabilities and own funds, whereas, along with senior unsecured bonds with a residual maturity over one year, cumulatively amount to **12.8%** of total liabilities and own funds, it is assumed that the inclusion of senior unsecured bonds in MREL is key point in order to ensure that an institution complies with the MREL.

8.2 Estimation of the MREL shortfall

The EBA attempted to estimate -based on two scenarios- the potential shortfall to arise from the obligation of institutions to meet the MREL:[90]

Scenario A:	***MREL threshold equal to double the minimum capital requirements including capital buffers*** (i.e. 8% of RWAs plus 2.5% capital conservation buffer plus G-SII buffer, where relevant), and
Scenario B:	***MREL threshold at 8% of total liabilities and own funds***.

[88] **EBA RTS (2015)**, p. 32.

[89] *Ibid*, pp. 32-33.

[90] *Ibid*, pp. 34-35.

Based on the preliminary QIS data, the EBA estimated that, if resolution authorities assessed that all senior unsecured debt with maturity of more than one year and uncovered deposits with maturity greater than one year were feasible and credibly loss-absorbing under:

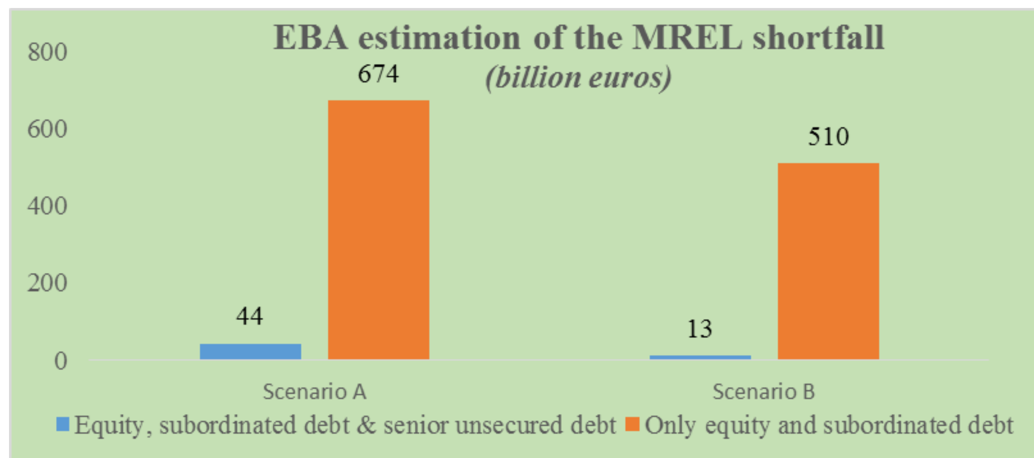
Scenario A:	14 institutions would have a shortfall of ***44 billion euros***
Scenario B:	7 institutions would have a shortfall amounting to ***13 billion euros***.

On the contrary, the relevant shortfall would be by far larger, in case that only equity and subordinated debt were included in the MREL. In particular under:

Scenario A:	52 institutions out of 64 (sample) would have a shortfall totaling ***674 billion euros***
Scenario B:	47 institutions would have a shortfall amounting to ***510 billion euros***

For a more illustrative presentation of the EBA estimations, see below:

Figure 1



Consequently, taking account of the EBA estimations it can be assumed that:

- in any case, **scenario A** implies greater shortfall for institutions which will come up against large issuances of eligible liabilities, mainly subordinated debt and senior unsecured debt, in order to satisfy the MREL, and
- it is of critical importance that resolution authorities ensure by any means they consider appropriate (see below, under Section D) that senior unsecured debt would count towards the MREL, otherwise the MREL shortfall would be vast and unattainable for institution to cover with alternative measures.

D. Policy options to cover the MREL

1. General remarks

According to the EBA impact assessment, the majority of institutions are not in position to cover MREL with existing equity and other own funds instruments, as it identified MREL shortfall in 52 out of 64 institutions under scenario A and in 47 out of 64 institutions under scenario B. Therefore, it can be reasonably assumed that the majority of institutions would have to take measures, either on their own initiative or under the resolution authority's mandate after the resolvability assessment, in order to comply with the MREL.

Policy options an institution may decide to apply are mainly related to issuance of capital instruments and eligible liabilities or implementation of arrangements appropriate to ensure that existing liabilities would fulfill certain criteria in order to count on the MREL. The most significant of the policy options (of structural and financial nature) available to institutions are presented below.

It is worth saying that among the following measures the most significant ones are those associated with subordination of senior unsecured debt to other senior unsecured liabilities, mainly regarding uncovered corporate deposits**.** Subordination can be achieved through the following means:[91]

- **i. structural subordination**, namely by setting up a parent financial holding company,
- **ii. contractual subordination** of senior unsecured debt, and
- **iii. statutory subordination** of senior unsecured debt**.**

2. Issuance of capital instruments and other subordinated debt

2.1 Issuance of capital instruments

Institutions may decide to comply with the MREL by issuing equity, additional Tier 1 instruments and Tier 2 instruments, which count towards both own funds requirements and the MREL. Despite the obvious drawbacks this proposal has, it allows institutions to meet the MREL in parallel with own funds requirements and other requirements set by supervisory authorities.

2.2 Issuance of other subordinated debt

Institutions may issue non-Tier 2 subordinated debt, though not recognised for prudential reasons in own funds under the provisions of **Article 62 CRR**. In this way, newly-issued subordinated debt would count on the MREL avoiding legal challenges, namely to put at risk the 'no creditor worse off principle'.

[91] **ECB (2015)**, p. 5.

3. Arrangements ensuring compliance with the MREL

3.1 Structural subordination

This policy option may be implemented where feasibility of resolution strategy with regard to banking groups requires the application of resolution tools at holding company level rather than to operating entities. Setting up a financial holding company as the parent entity of the group instead of an institution is a credible measure to cope with any risks that may arise due to potential exclusions of certain liabilities from the bail-in power.

To be exact, parent financial holding companies are not authorised to take deposits, since, according to **Article 9(1) CRD IV**, only credit institutions are entitled to carry out the business of taking deposits. Therefore, in contrast to institutions where corporate deposits rank *pari passu* with other senior unsecured liabilities, setting up a parent holding company enables resolution authorities to count senior unsecured debt issued at holding company level towards the MREL, avoiding the risk of breaching the 'no creditor worse off principle'. Where necessary, the parent holding company's liability structure should contain only equity and eligible liabilities expected to contribute to loss absorption and recapitalisation.[92]

3.2 Contractual subordination of senior unsecured debt

Since there is no harmonisation at EU level of creditor hierarchy in institution insolvency proceedings, Member States may legislate on their own initiative an amendment to their national insolvency law in order to permit institutions to issue ***senior debt with subordination clauses embedded*** (known as ***subordinated senior bonds*** or ***Tier 3 bonds***). Tier 3 bonds would be for purposes of normal insolvency proceedings subordinated to senior unsecured debt, as well as to uncovered deposits, and senior to Tier 2 capital instruments.

Operating entities would be significantly benefited from this policy option, as they would effectively encounter the risk of breaching the 'no creditor worse off principle'. In particular, since uncovered corporate deposits, which are likely to be excluded from bail-in under **Article 44(3) BRRD**, rank equally to senior bonds, in case of resolution bondholders would incur greater losses than they would have incurred if the institution had been liquidated under normal insolvency proceedings. Therefore, institutions to issue Tier 3 bonds could comply with the MREL avoiding possible legal challenges.

Spain was the first country to adopt this approach by incorporating an amendment to its national insolvency law seeking to achieve a dual goal: to strengthen the ability of Spanish institutions to meet the MREL and to provide legal certainty to shareholders, creditors and other stakeholders of institutions with regard to the implementation of resolution tools.

3.3 Statutory subordination of senior unsecured bonds

Alternative to contractual subordination is the statutory subordination of senior unsecured bonds. Specifically, senior unsecured bonds issued by institutions would be subordinated in insolvency proceedings to uncovered corporate deposits and other senior liabilities deemed as likely to be excluded from bail-in under **Article 44(3) BRRD**.

[92] **EBA Guidelines (2014a)**, point (14).

Statutory subordination applies to existing senior unsecured bonds, which implies that institutions could meet the MREL easier than in case of adopting the contractual subordination approach. Therefore, statutory subordination allows the resolution authority to count existing senior unsecured bonds towards the MREL, without the need for any action from the issuer, as is the case for contractual subordination.[93]

Greece was the first Member State to adopt the statutory subordination approach, according to which corporate deposits rank senior to other senior unsecured liabilities, such as senior unsecured bonds.[94] Furthermore, Germany adopted legislation amending national insolvency law pursuing to facilitate the application of resolution tools and the implementation of the MREL. The new law provides for the statutory subordination in insolvency proceedings of certain senior unsecured debt instruments to interbank deposits, corporate deposits, money market instruments, certain claims under derivative transactions and structured notes with derivative-linked features. New German law for statutory subordination will apply as of 1 January 2017.

Both contractual and statutory subordination are useful for banking groups with operating parent company model alleviating the advantage that groups with financial parent holding company have. Adopting the subordination policy option implies that it is likely to avoid any compensation claims of the affected bondholders under the 'no creditor worse off principle'.

3.4 Renegotiation of terms and conditions of eligible liabilities and capital instruments

An institution may on its own initiative or if required by the resolution authority pursuant to **Article 17(5), point (j) BRRD** attempt to renegotiate any eligible liability and additional Tier 1 or Tier 2 instruments it has issued in order to meet the MREL. That policy option seeks to ensure that any decision of the resolution authority to write down or convert that liability or instrument would be effected under the law of the jurisdiction governing that instrument. In particular, an institution may renegotiate specific terms and conditions of the liabilities, including inter alia:[95]

- maturity,
- subordination ranking,
- types of holders and transferability,
- the risk that the liabilities would be exempted from absorbing losses in resolution, and
- other legal obstacles, such as the absence of recognition of resolution tools under third country law or the existence of set-off rights.

[93] **ECB (2015)**, p. 3.

[94] **Law 4261/2014**, Article 145A(1).

[95] **EBA Guidelines (2015a)**, par. 16.

Concluding remarks

The establishment of harmonised rules at EU level concerning resolution is a major step towards ensuring financial stability without recourse to bail-outs with taxpayers' money. To achieve this goal, it is necessary to implement the arrangements laid down in the BRRD consistently and in time. The application of resolution tools and the exercise of resolution powers should be the last stage of a procedure pursuing to enhance the ability of institutions to overcome expected and unexpected stress events and the ability of competent authorities to cope with any problems that may arise on individual or systemic basis.

The application of resolution tools by itself cannot guarantee the orderly resolution of ailing institutions in an efficient and credible manner, if it has not preceded the consistent application of preparatory and preventive measures stipulated in the BRRD. It is a sine qua non for the application of resolution tools, supervisory and resolution authorities to have effectively executed their tasks, especially with regard to:

- assessment of recovery plans submitted by institutions,
- resolution planning,
- assessment of institutions' resolvability and taking measures to remove or address impediments to resolvability,
- determination of the MREL institutions have to comply with, by setting not only the suitable MREL ratio but also the appropriate level (at parent entity or subsidiaries level) within banking groups that the MREL must be met in accordance with the preferred resolution strategy (SPE or MPE strategy), and
- taking early intervention measures.

In order to avoid posing any threat to the credibility of resolution, it is of critical importance that resolution authorities set the MREL ratio at an appropriate level and ensure its cover by liabilities that are unlikely to give rise to legal risks owing to breach of 'no creditor worse off principle'. In this way, resolution authorities would be able to resolve unsound institutions without exercising write-down and conversion powers to uncovered deposits of natural persons and enterprises, which would distort the functioning of financial markets and the economy of Member States or the EU as a whole.

In any case, the effectiveness and credibility of the MREL depends on resolution authorities' response to the following challenges.

First of all, resolution authorities must **set the MREL ratio at an appropriate level**. Given that there is no single MREL ratio applicable to all institutions, resolution authorities are responsible for setting the MREL ratio that each institution has to meet based on its own characteristics. When determining the MREL ratio it is necessary resolution authorities to strike the right balance between enhancing their own ability to resolve effectively ailing institutions and avoiding excessive and undue obligations for institutions.

The most critical point in determining the MREL pertains the level of the recapitalisation amount, which is the second component of the MREL. In particular, the recapitalisation amount must be set at a level that allows the institution under resolution not only to satisfy capital requirements necessary to meet the conditions for authorisation, but also to sustain market confidence. The level of the recapitalisation amount depends to a significant degree on the content of the resolution plan, mainly

with regard to the preferred resolution strategy, and its provisions on resolution tool applied to institution, as well as on the volume of its post-resolution RWAs.

Internal allocation of the MREL is the second challenge of resolution authorities. Dependent on the preferred resolution strategy, resolution authorities should consider requiring an institution to issue at the appropriate level a sufficient amount of liabilities qualifying in the MREL. For an SPE strategy, liabilities contributing to loss absorption should be sufficient to absorb losses across the banking group and, in accordance with the resolution strategy, to ensure the integrity and operability of those parts of the group, where critical functions are performed. In the absence of sufficient liabilities expected to contribute to loss absorption and recapitalisation at subsidiary level and, if necessary to implement an SPE resolution strategy, resolution authorities should consider requiring the parent entity to provide funding to subsidiaries in subordinated form to facilitate the upstreaming of losses from the subsidiary, thereby avoiding entry of the subsidiary into resolution.[96] For an MPE strategy, resolution authorities should ensure that liabilities contributing to loss absorption should be sufficient at each point of entry to absorb losses across those entities included in the MPE resolution unit.

Defining the **appropriate phase-in period** is a challenging task for resolution authorities. The Commission Delegated Regulation 2016/1450 provides resolution authorities with the discretion to require institutions to meet a lower MREL during a transitional period. The purpose of that arrangement is to grant institutions the necessary timeframe to meet the MREL without having to issue concurrently large amounts of capital and debt instruments. Otherwise, any requirement of resolution authorities institutions to cover MREL shortfall in a short timeframe would hamper their ability to raise external funds in time and at a reasonable cost and, subsequently, to finance the economy under good conditions.

However, resolution authorities should give due account to the need that may arise to resolve an unviable institution or to handle a systemic crisis in the years preceding 2020, when institution would meet the MREL in full. In that case, since institutions would not have sufficient capital and debt instruments to absorb losses, resolution authorities may have to take alternative measures so as to apply resolution tools in an effective way, including the application of the bail-in tool to uncovered depositors, with all the negative implications accompanied.

So, when setting the MREL ratio during the transitional period, resolution authorities should strive to achieve a dual goal: to ensure the feasibility and credibility of resolving failing institutions and to avoid putting in danger the ability of institutions to cover any MREL shortfall without repercussions for the viability of their own business model and for the interests of the EU economy.

Furthermore, it is necessary resolution authorities to ensure **harmonised application of the MREL across Member States:** The BRRD does not establish a single MREL ratio applicable to all institutions, allowing resolution authorities wide discretion to set the MREL ratio for each institution based on case-by-case judgements in accordance with certain criteria specified by the EBA. However, it is necessary these criteria be interpreted and applied consistently across jurisdictions in order to ensure that similar levels of the MREL are set for institutions with similar characteristics.

The establishment of the SRM is expected to contribute to the harmonised application of the MREL in the participating in the EBU jurisdictions, since the relative decisions would be taken by the SRB (in respect of significant institutions) and national resolution authorities (in respect of other institutions) under the guidelines and general

[96] *Ibid*, point (15).

instructions issued by the SRB.[97] Therefore, it is plausible to consider that the SRB and the national resolution authorities would interpret and apply the relevant criteria in a uniform way across the whole EBU.

Divergent application of the MREL criteria with regard to comparable institutions would be among the areas examined by the EBA in the report that has to be submitted to the Commission by 31 October 2016. To ensure the level playing field within the internal market, the Commission, based on that report, may submit to the European Parliament and the Council by the end of 2016 a legislative proposal for the harmonisation of the MREL, including the introduction of an appropriate number of minimum levels of the MREL, taking account of different business models of institutions and groups.

National arrangements on subordination of senior unsecured debt to other senior unsecured liabilities, such as corporate deposits, is a further field that requires harmonisation across Member States. In particular, it is necessary a common approach (statutory or contractual subordination) to be adopted, preferably via a Union legislative initiative in order to harmonise the way institutions' insolvency ranking is modified in each jurisdiction.

Otherwise, divergent practices across Member States would hinder orderly resolution of banking groups whose entities are incorporated across various Member States and would contribute to fragmentation of the internal market, in terms of, *inter alia*, cost of funding for institutions and implementation of monetary policy, as the ECB explicitly admits.[98]

Lastly, resolution authorities must ensure **consistent application of the Total Loss Absorbency Capacity (**hereinafter the **'TLAC') requirement in respect of G-SIIs.** On 9 November 2015, the Financial Stability Board (hereinafter '**FSB**') endorsed a standard pertaining the establishment of a new requirement for G-SIIs, the **TLAC**.[99] The aim of this initiative is to tackle with the "too big to fail" problem by enhancing the loss absorbing capacity of G-SIIs on both a going concern and gone concern basis and help resolution authorities to resolve these financial institutions in an orderly manner without taxpayer support.

The G-SIIs incorporated in EU Member States would have to meet both the TLAC and the MREL. Although the rationale of both requirements is similar, there are substantial differences and inconsistencies between them, mainly with regard to the level of the ratio, the role of capital buffers, the eligibility of instruments and the implementation date.

In this context it is crucial the TLAC standard to be introduced into Union law and be applied by resolution authorities in a manner that would guarantee that EU-based G-SIIs could fulfill both requirements (TLAC and MREL) without being at a disadvantage compared to peers established in third countries.

[97] **SRMR**, Article 31(1), point (a).

[98] **ECB (2015)**, p. 6.

[99] For more information on the TLAC, see **Financial Stability Board (2015)**.

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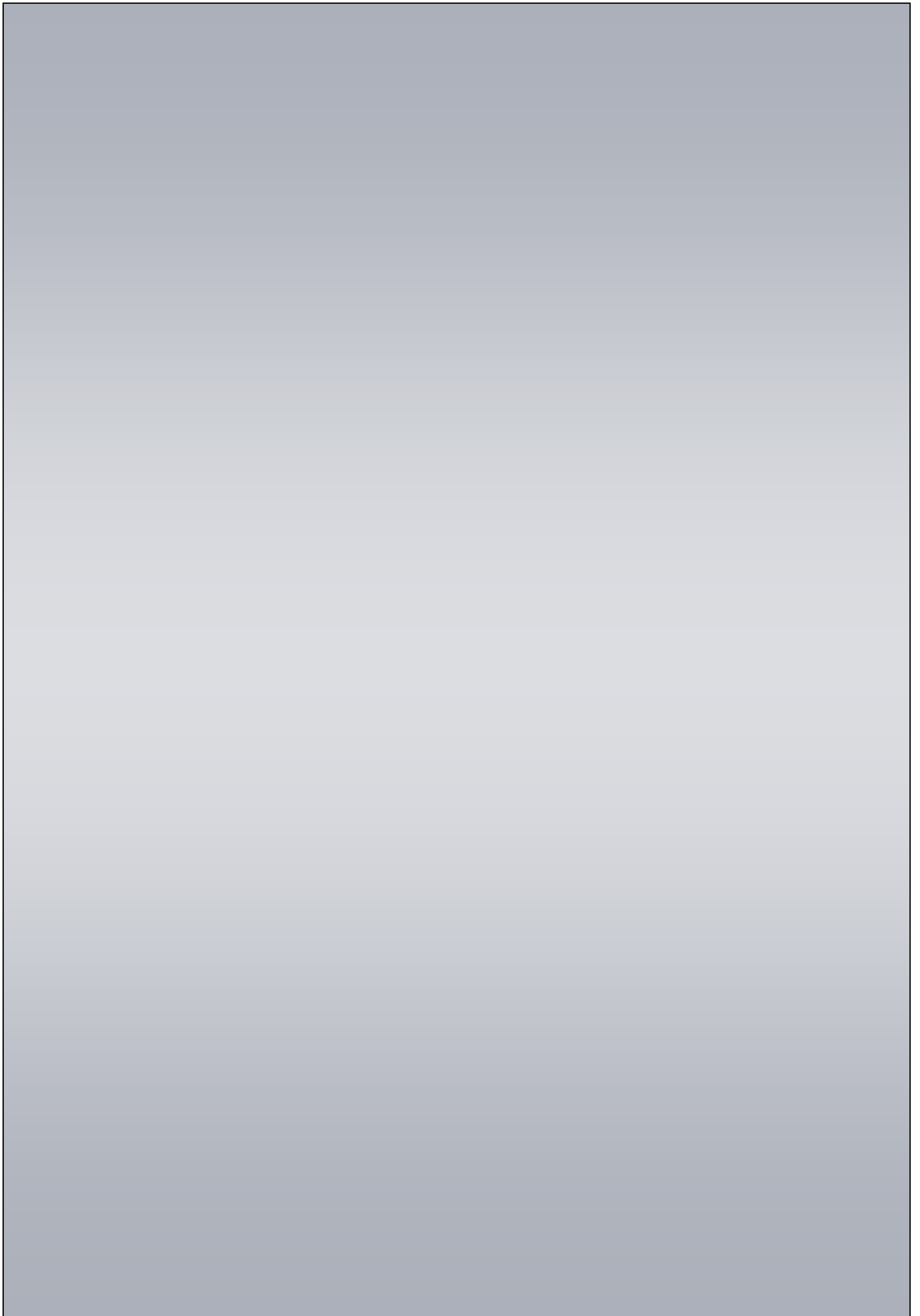

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