

## Total Loss-absorbing Capacity (TLAC) Term Sheet

Financial Stability Board (FSB)

# List of abbreviations

Abbreviations	Meaning
bps	Basic points
CBR	Combined buffer requirement
CET 1	Common Equity Tier 1
CMG	Crisis Management Group
EME	Emerging market economies
G-SIBS	Global systemically important banks
LRE	Leverage ratio exposure
MDA	Maximum distributable amount
MPE	Multiple points of entry
MREL	Minimum requirement for own funds and eligible liabilities

Abbreviations	Meaning
NII	Net interest income
O-SII	Other systemically important institutions
RA	Resolution authorities
RAP	Resolvability assessment process
RCA	Recapitalisation amount
RWA	Risk weighted assets
SPE	Single points of entry
TLAC	Total-loss absorbing capacity
TLOF	Total liabilities and own funds
TBTF	Too-big-to fail

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# Introduction

## The FSB published in November 2015 the final standard on the total loss-absorbing capacity (TLAC) requirement, which defines a minimum requirement for the instruments and liabilities that should be available for bail-in within resolution at G-SIBs

### Introduction

- The “too-big-to-fail” (TBTF) problem arises when the failure of a systemically important financial institution leaves public authorities with no option but to bail it out using public funds to avoid financial instability and economic damage. The knowledge that this can happen encourages those institutions to take excessive risks.
  - In this regard, at the **St. Petersburg Summit in 2013** the G20 Leaders called on the FSB to assess and develop proposals by end-2014 on the adequacy of the loss absorbing capacity of those entities when they fail.
  - To this end, on November 2014 the FSB published, in consultation with the BCBS, a consultative document on the **total loss-absorbing capacity** (TLAC) of **global systemically important banks** (G-SIBs) in resolution.
- After the consultation period, the FSB published the final standard on TLAC for G-SIBs on November 2015, including **high level principles** and a **detailed Term Sheet**.
  - This standard defines a **minimum requirement** for the **instruments and liabilities that should be readily available for bail-in within resolution** at G-SIBs, but does not limit authorities’ powers under the applicable resolution law to expose other liabilities to loss through bail-in or the application of other resolution tools.
  - The objective of the standard is to ensure that G-SIBs have the **loss-absorbing and recapitalisation capacity** necessary to help ensure that, in the event of resolution, critical functions can be continued without taxpayers’ funds or financial stability being put at risk.

This document analyses the Term Sheet published by the FSB and the major implications for financial institutions arising from its implementation.

# Introduction

## TLAC definition

**There are two types of TLAC requirements: an External TLAC requirement, which applies to resolution entities<sup>1</sup>; and an Internal TLAC requirement, which applies to subsidiaries considered material sub-groups<sup>1</sup>**

### TLAC definition

The TLAC consists of **instruments** that an institution must hold and that can be legally, feasibly, effectively and operationally **written down** or converted into equity in case of resolution, in an **amount that exceeds the capital and leverage** requirements.

#### External TLAC requirement

- Issued by each **resolution entity** to **third parties**.
- Eligible instruments (debt and equity that count as Tier 1/Tier 2 and other debt) over a **resolution entity's** risk weighted assets (RWAs) and leverage exposure amount (LRE):

$$\frac{\text{Eligible instruments}}{\text{RWAs}} \geq 18\%$$

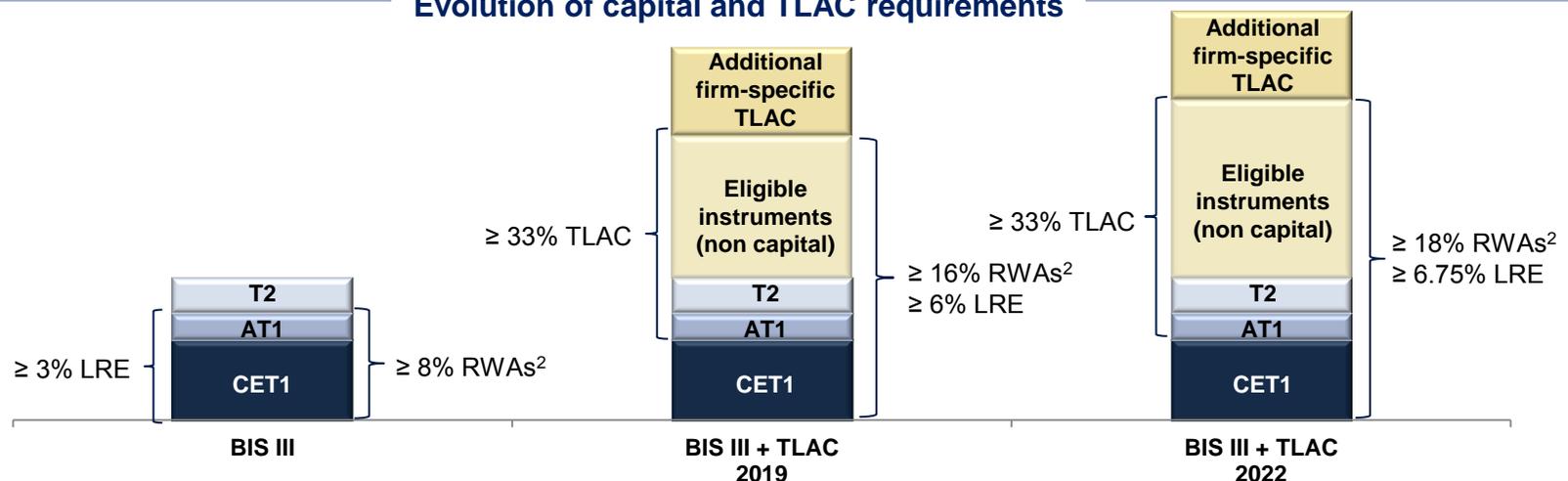
$$\frac{\text{Eligible instruments}}{\text{LRE}^1} \geq 6.75\%$$

- Authorities may set **firm-specific TLAC** above the minimum.

#### Internal TLAC requirement

- Issued by the **material sub-group** to the **resolution entity**.
- **75 – 90%** of the Minimum External TLAC that would apply if the material sub-group (a material subsidiary of the G-SIB) were a resolution group. The Minimum Internal TLAC within that range should be determined by the host authority (in consultation with the home authority).
- Authorities may set **firm-specific TLAC**.

### Evolution of capital and TLAC requirements



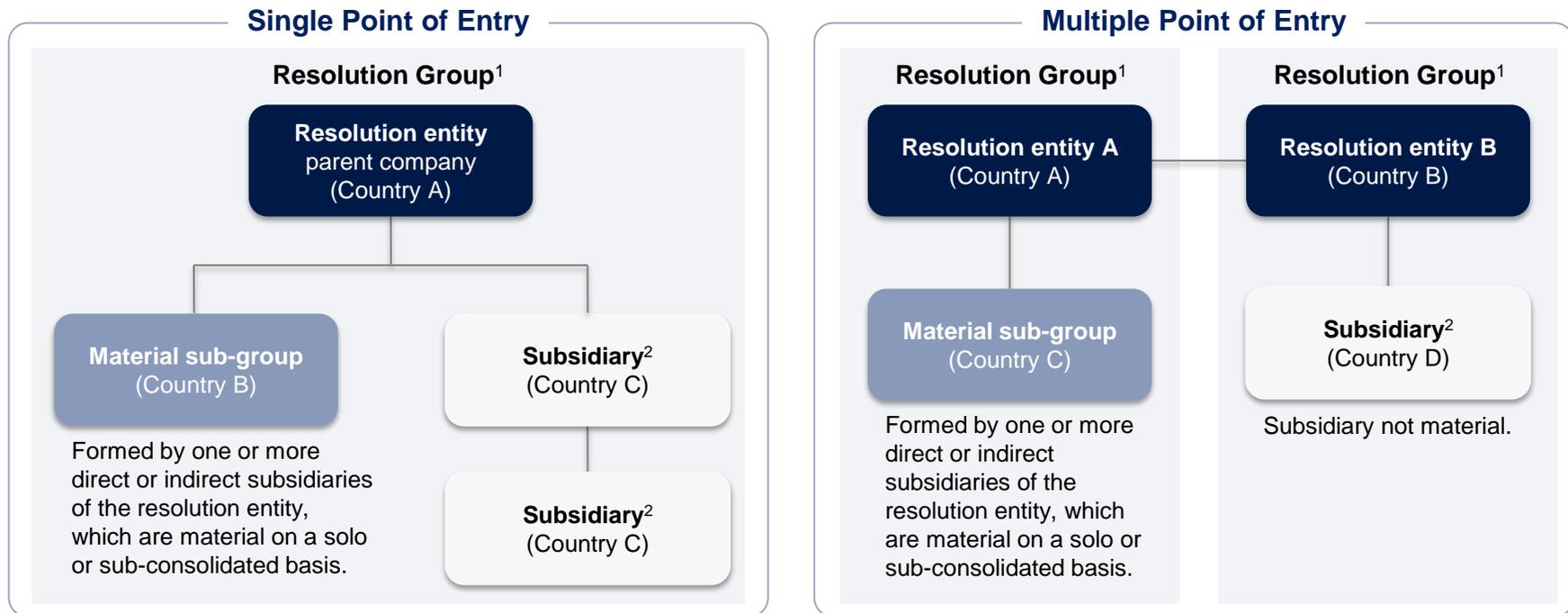
# Introduction

## TLAC allocation

### Resolution groups shall apply resolution tools through single point of entry or multiple point of entry

#### TLAC Allocation

- The **Minimum External TLAC** is applied to each **resolution entity** within each G-SIB, and it will be set in relation to the consolidated balance sheet of each resolution group, whereas the **Minimum Internal TLAC** is applied to each **material sub-group** within each G-SIB.
- The following figure shows the **TLAC allocation within resolution groups**, both for single point of entry and multiple point of entry of entry banking groups.



 Institutions to which the Minimum External TLAC applies  Institutions to which the Minimum Internal TLAC applies

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# Executive summary

**The Term Sheet contains an External TLAC requirement and an Internal TLAC requirement, as well as a disclosure requirement on some information regarding the TLAC**

## Executive summary

### Scope of application

- **Global Systemically Important Banks (G-SIBs).**

### Regulatory context

- Key Attributes of Effective Resolution Regimes for Financial Institutions, published by the FSB on **October 2011** and then updated in 2014.
- CP on Adequacy of loss-absorbing capacity of G-SIBs in resolution, issued by the FSB on **November 2014**.

### Next steps

- G-SIBs will be required to begin to comply with the requirements specified in the Term Sheet as of **1 January 2019**.
- The FSB will undertake a review of the technical implementation of the standard by the **end of 2019**.

## Main content

### External TLAC

- **Minimum External TLAC:** set initially at 16% of RWAs and 6% of the leverage exposure amount (LRE) applied to each resolution entity within G-SIBs. However, authorities may apply additional firm-specific requirements above the common TLAC.
- **Eligible instruments:** regulatory capital may count towards satisfying the Minimum External TLAC, subject to certain conditions (e.g. CET1 use to meet Minimum External TLAC must not be used to meet regulatory capital buffers). Moreover, there is an expectation that Tier 1 and Tier 2<sup>1</sup> plus other non-regulatory capital instruments are at least 33% of the Minimum External TLAC.
- **Deduction of the eligible External TLAC issued by other G-SIBs:** internationally active banks, both G-SIBs and non-G-SIBs have to deduct from their own Tier 2 capital their net TLAC holdings (including holdings of own TLAC and reciprocal cross holdings). The BCBS has published a consultative document developing this provision.

### Internal TLAC

- Set at **75% - 90%** of the Minimum External TLAC that would apply to the material sub-group if it were a resolution group.

### Disclosure

- G-SIBs, resolution entities and entities part of a material sub-group must **disclose information** with regard to the TLAC.

(1) Tier 1 and Tier 2 in the form of debt liabilities.

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# Final standard on TLAC

## External TLAC

**The Minimum External TLAC shall be at least 16% of the resolution group's RWAs and 6% of the LRE as from 1 January 2019. Authorities may apply additional firm-specific requirements above the common TLAC**

### Minimum External TLAC: main features

#### Level of application

- Applied to each **resolution entity** considering the **consolidated balance sheet** of each resolution group.
- For G-SIBs with **more than one resolution entity** and **resolution group**, the following shall be taken into consideration:

#### Treatment of Internal exposures

- All **exposures to entities in other resolution groups** of the same G-SIB shall be included in the consolidated balance sheet of the resolution group.
- If those exposures correspond to **items eligible for TLAC** they should be **deducted** from TLAC resources. The deduction also applies to items eligible for TLAC issued from a resolution entity to a parent that is also a resolution entity.

#### Adjustment

- If the sum of Minimum External TLAC requirements of the resolution entities within the same G-SIB is above the Minimum External TLAC requirement that would apply if the G-SIB had only one resolution entity, the home and relevant host authorities may agree on an **adjustment to minimise or eliminate** that difference.

#### Calibration

- At least **16%** of the resolution group's **RWAs** (TLAC RWA) and **6%** of the **LRE**, as from 1 January 2019.
- Regulatory capital **buffers** are not included in the TLAC RWA requirement, they must be met in addition to the latter.

#### Additional TLAC

- Home authorities of resolution entities, in consultation with the CMG<sup>1</sup> and subject to review in the Resolvability Assessment Process (RAP), should apply **additional firm-specific requirements** above the common Minimum External TLAC if they determine that this is necessary and appropriate.

#### Breach of the Minimum External TLAC

- Supervisory and resolution authorities shall treat the breach as seriously as a breach, or likely breach, of **minimum regulatory capital requirements**.
- G-SIBs should be **prohibited from redeeming eligible External TLAC** prior to maturity without supervisory approval if the redemption would lead to a breach of the G-SIB's TLAC requirements.

(1) Crisis Management Group.

# Final standard on TLAC

## External TLAC

**Instruments eligible as regulatory capital may also count towards satisfying the TLAC, subject to certain conditions. There is an expectation that the Tier 1 and Tier 2 in the form of debt liabilities plus other non-regulatory capital instruments are at least 33% of the TLAC**

### Minimum External TLAC: relationship with capital requirements

#### Relationship with capital requirements

- Expectation: **Tier 1 and Tier 2 capital in the form of debt liabilities + other TLAC-eligible instruments  $\geq$  33% of Minimum External TLAC** requirements.
- Capital used to comply with minimum regulatory capital requirements may count towards satisfying the Minimum External TLAC requirement subject to the following **restrictions**:

#### CET1 capital instruments

- CET1 used to meet Minimum External TLAC must not be used to also meet **regulatory capital buffers**.

#### Other capital instruments (non-CET1)

- They may be issued under the laws of a jurisdiction other than that of the resolution entity only if under those laws the resolution entity's resolution authority is capable of applying **resolution tools effectively**.
- Non-CET1 issued by **subsidiaries** of the resolution entity located in a jurisdiction other than that of the resolution entity must be capable of being written down or converted to equity at the point of non-viability of the subsidiary.

#### Related parties

- Regulatory capital instruments must not be **funded** directly or indirectly by a **party related** to the resolution entity<sup>1</sup>.

#### Material sub-group

- Regulatory capital issued from entities of a material sub-group may count towards Minimum External TLAC only if home and host authorities agree that their conversion into equity would not cause a **change of control** of the entities.

#### Transitional provision

- As from **1 January 2022**, regulatory capital instruments used to meet TLAC must meet the **requirements set out hereafter** and be **issued from the resolution entity**<sup>2</sup>.

(1) Except where the home and host authorities in the CMG agree that it is consistent with the resolution strategy.

(2) Subject to certain exceptions (e.g. CET1 regulatory capital issued from subsidiaries forming part of the resolution entity's resolution group to the extent that this is recognised as CET1 for the consolidated resolution entity).

# Final standard on TLAC

## External TLAC

**Instruments eligible as TLAC must be issued and maintained directly by resolution entities, except for some cases. Moreover, they must meet a set of criteria, such as to be paid in and unsecured, to have a maturity of at least one year, etc.**

### Eligible instruments

#### Issuer requirement

- TLAC must be issued and maintained directly by **resolution entities** subject to the following **exceptions**:
  - **CET1** issued from **subsidiaries** forming part of a resolution entity's resolution group and held by third parties to the extent that this is recognised as CET1 for the consolidated resolution entity<sup>1</sup>.
  - **Regulatory capital instruments** issued by **cooperative banks or financial institutions affiliated to them** that have in place an institutional protection scheme or other similar system<sup>2</sup>.
  - **Debt liabilities** issued indirectly by a **wholly and directly owned funding entity** of the resolution entity prior to 1 January 2022, provided that certain conditions are met (e.g. legal certainty that the issued TLAC will absorb losses at the resolution entity).

#### Eligibility criteria

- Be **paid in**.
- Be **unsecured**.
- Not be subject to set off or **netting rights** that would undermine their loss absorbing capacity
- Have a minimum remaining contractual **maturity of at least one year** or be **perpetual**.
- Not be redeemable by the holder (i.e. not contain an exercisable put) prior to maturity.
- Not be funded directly or indirectly by the **resolution entity or a related party** of the resolution entity, except where it is permitted by the relevant home and host authorities in the CMG.

#### Liabilities excluded from TLAC

- **Insured deposits**.
- **Sight deposits** and **short term deposits** (deposits with original maturity of less than one year).
- Liabilities arising from **derivatives**, and debt instruments with derivative-linked features.
- Liabilities arising **other than through a contract**, such as tax liabilities.
- Liabilities which are **preferred to senior unsecured creditors** under the relevant insolvency law.
- Any liabilities that, under the relevant laws, are **excluded from bail-in** or cannot be written down or converted into equity without giving rise to material risk of successful legal challenge.

(1) Regulatory capital instruments, other than CET1, issued from subsidiaries may only be used to meet Minimum External TLAC until 31 December 2021.

(2) Provided that the regulatory capital instruments continue to meet certain conditions.

# Final standard on TLAC

## External TLAC

**TLAC instruments must meet a subordination requirement, the eligible External TLAC must be subject to the law of the relevant resolution entity jurisdiction and contain a contractual trigger**

### Eligible instruments

#### Subordination requirement

- Eligible TLAC must be:
  - Contractually subordinated to excluded liabilities on the balance sheet of the resolution entity (“**contractual subordination**”);
  - Junior in the statutory creditor hierarchy to excluded liabilities on the balance sheet of the resolution entity (“**statutory subordination**”); or
  - Issued by a resolution entity which does not have any excluded liabilities or junior to TLAC-eligible instruments on its balance sheet (“**structural subordination**”).
- The subordination requirement does not apply in those jurisdictions in which all liabilities excluded from TLAC are excluded from the **scope of the bail-in tool**.
- In those jurisdictions where the **resolution authority may exclude** or partially exclude from bail-in all of the **liabilities excluded from TLAC**, the relevant authorities may permit excluded liabilities to contribute a quantum equivalent of up to **2.5% RWA** (when the TLAC RWA Minimum is 16%) and up to **3.5% RWA** (when the TLAC RWA Minimum is 18%).

#### Governing law

- The law of the **jurisdiction** where the **relevant resolution entity is incorporated**.
- It may be issued under or be otherwise subject to the laws of **another jurisdiction** if, under those laws, the application of resolution tools by the relevant resolution authority is effective and enforceable.

#### Triggers

- Eligible External TLAC should contain a **contractual trigger** or be subject to a statutory mechanism which permits the relevant resolution authority to effectively **write it down or convert it to equity in resolution**.

(1) Subordination is not required if certain conditions are met (the amount of excluded liabilities or junior to the TLAC-eligible liabilities does not exceed 5% of the resolution entity’s eligible External TLAC; subordination does not have a material adverse impact on resolvability; etc.).

# Final standard on TLAC

## External TLAC

To reduce the risk of contagion, the Term Sheet requires G-SIBs to deduct their investments in External TLAC issued by other G-SIBs from their own TLAC or regulatory capital. The BCBS has published a consultative document developing this provision

### Deduction of investment in TLAC

#### Deduction of investments in TLAC

- G-SIBs have to deduct from their TLAC or regulatory capital exposures the **eligible External TLAC issued by other G-SIBs**.
- The BCBS has published a **consultative document** (*TLAC Holdings*) developing this provision.

### TLAC holdings (BCBS, Nov.15)

#### Scope

- **Internationally active banks**, both G-SIBs and non-G-SIBs.

#### Requirement

- To **deduct from their own Tier 2 capital their net TLAC holdings** (including holdings of own TLAC and reciprocal cross holdings) that do not otherwise qualify as Basel III capital.
  - Where a bank owns **more than 10%** of the common shares of the issuer, holdings of TLAC would be **fully deducted**.
  - Where a bank owns **less than 10%** of the common shares of the issuer, holdings of TLAC of that issuer would be deducted subject to a **threshold**.

#### Definition of TLAC Holding

- Investments in TLAC:
  - Includes all holdings of **instruments that are eligible as TLAC** by the issuing G-SIB, or that rank pari passu to any of such instruments.
  - Exclude all holdings of instruments listed within the **excluded liabilities**.
  - Exclude all holdings of instruments that have an original **maturity of less than one year that rank pari passu** to excluded liabilities and that have been issued by G-SIBs in jurisdictions that apply the exemptions to the subordination requirements.

# Final standard on TLAC

## Internal TLAC

**The main function of Internal TLAC is to ensure the appropriate distribution of loss-absorbing and recapitalisation capacity within resolution groups outside of their resolution entity's home jurisdiction**

### Internal TLAC

#### Size of the Internal TLAC requirement

- **75% to 90%** of the Minimum External TLAC requirement that would apply to the material sub-group if it were a resolution group. Host authorities may establish firm-specific Internal TLAC requirements.
  - The host authority should calculate the sub-consolidated balance sheet of the material sub-group (not including exposures between entities within the same material sub-group), which will be the **denominator of the Internal TLAC calculation**.
  - The resolution entity should issue and maintain at least **as much External TLAC as the sum of Internal TLAC and any TLAC needed to cover material risks** on the resolution entity's own balance sheet.

#### Eligible Internal TLAC

- **Core features:** the same as those for eligible External TLAC, except with regard to the issuing entity and permitted holders.
- **Liabilities excluded:** the same as for eligible External TLAC.
- Internal TLAC that comprises **regulatory capital instruments** must comply with the **relevant provisions of Basel III<sup>1</sup>**.
- Internal TLAC must be subject to **write-down and/or conversion to equity** by the relevant host authority at the point of non-viability without entry of the subsidiary into statutory resolution proceedings, being subject to consent from the relevant authority.
- Home and relevant host authorities in CMGs may agree to **substitute** on-balance sheet Internal TLAC with Internal TLAC in the form of **collateralised guarantees**, subject to certain conditions (e.g. guarantee is provided for at least the equivalent amount as the Internal TLAC; collateral backing the guarantee is sufficient to cover the amount guaranteed; etc.).

(1) Regulatory capital instruments other than CET1 issued externally out of a subsidiary belonging to a material sub-group and held by third parties may count towards that material sub-group's Internal TLAC requirement only until 31 December 2021, subject to agreement between home and host authorities.

# Final standard on TLAC

## Disclosure

### G-SIBs, resolution entities and entities part of a material sub-group must disclose information with regard to the TLAC

#### Disclosure

##### G-SIBs

- G-SIBs must disclose the **amount, maturity, and composition** of **External and Internal TLAC** that is maintained, respectively, by each resolution entity and at each legal entity that forms part of a material sub-group and issues Internal TLAC to a resolution entity.

##### Resolution entities

- Resolution entities must disclose, at a minimum, the **amount, nature and maturity of any liabilities** which in the relevant insolvency creditor hierarchy **rank pari passu or junior to liabilities which are eligible as TLAC**.

##### Entities part of a material sub-group

- Entities that are part of a material sub-group and issue Internal TLAC to a resolution entity must disclose any **liabilities which rank pari passu with or junior to Internal TLAC** issued to a resolution entity.



The **Basel Committee of Banking Supervision (BCBS)** will further specify this provision.

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# Implications

## Compliance with TLAC requirements will have implications for G-SIBs with regard to governance, funding structure, monitoring of net interest income (NII) and disclosure

### Implications



- G-SIBs will have to take into consideration the **resolution strategy** when allocating TLAC instruments into the different legal entities within each G-SIB, to ensure that each resolution entity complies with the Minimum External TLAC and that material sub-groups hold enough Internal TLAC.
- More resources shall be allocated** to the units responsible for calculating capital requirements, so they assure compliance with TLAC.



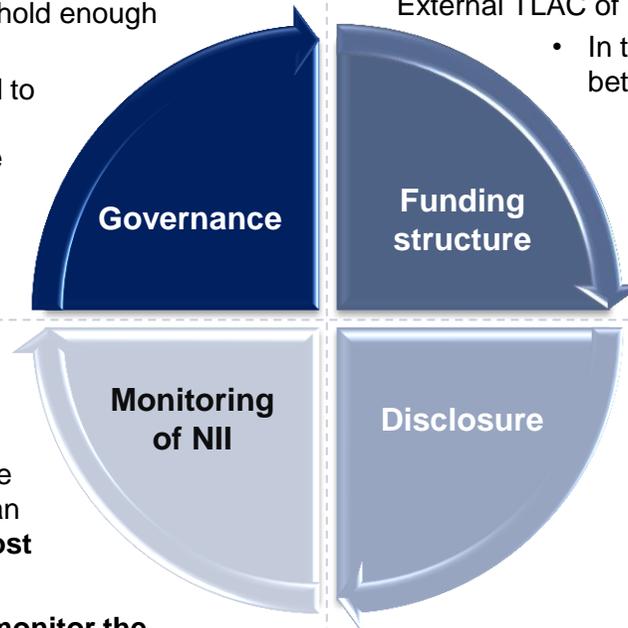
- G-SIBs will have to **issue TLAC eligible instruments or replace** some of their existing securities with more expensive TLAC eligible securities until they fill their TLAC shortfall. The aggregate shortfall of External TLAC is **€767bn** (considering a External TLAC of 16% of RWAs and of 6% LRE<sup>1</sup>).
  - In the EU the **funding needs of MREL** range between **€186bn** and **€276bn**<sup>2</sup>.
    - G-SIBs will have to monitor that they comply with the expectation that the sum of T1 and T2 capital in the form of debt liabilities plus other non-capital TLAC-eligible instruments is at least **33% of the TLAC**.



- As TLAC eligible instruments are more expensive, G-SIBs will have to **consider to pass the additional funding costs to their clients** in the form of higher loan rates. The median increase of the weighted average **cost of funds is 42.7 bps**<sup>1</sup>.
- As a result, institutions will have to **monitor the impact on net interest income (NII)**. The median increase in interest costs is about **1.6% of NII**<sup>1</sup>.



- G-SIBs, resolution entities and entities part of a material sub-group will have to **disclose information** with regard to the amount, maturity, and composition of External and Internal TLAC.



(1) *Assessing the economic costs and benefits of TLAC implementation*, BIS (November 2015).

(2) *Final Report on the implementation and design of the MREL framework*, EBA (Dic.2016). See

[Annex 2](#) for more information on the EBA's recommendations with regard to the design of the MREL and on the impact of MREL.

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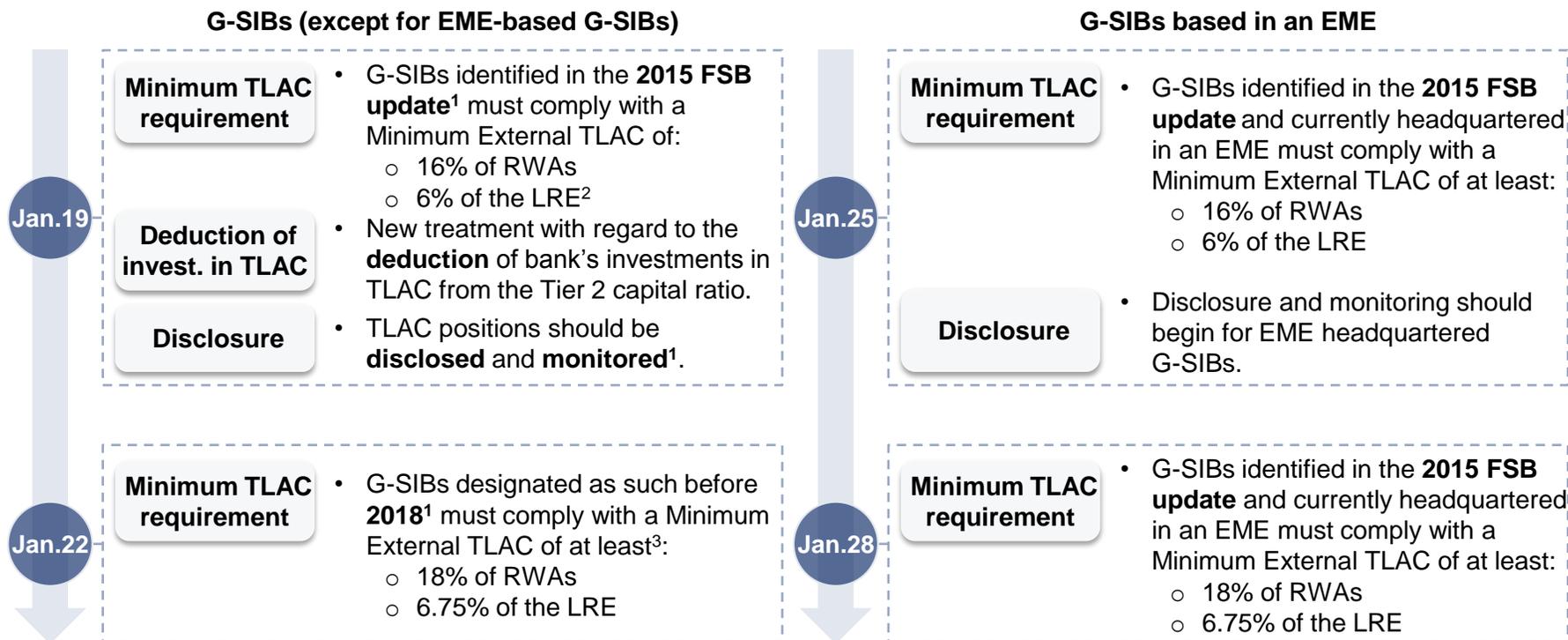
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# Next steps

## Timeline

The Minimum External TLAC requirement will be phased in, beginning as of 1 January 2019. Implementation dates are different for G-SIBs headquartered in an emerging market economy (EME)

### Timeline



Any G-SIB that fails and enters resolution, or its successor bridge entity, should be allowed up to **24 months** to come back into compliance with the **FSB TLAC** standard following the date on which it exits resolution.

(1) With the exception of such firms headquartered in an EME.  
 (2) Basel III Leverage Ratio Exposure denominator.  
 (3) G-SIBs designated as such after 2018 must meet Minimum TLAC requirements of at least the amount defined within 36 months from their date of designation.

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# Annex 1

## Main concepts

**Resolution authorities are those entities to which the resolution tools will be applied in accordance with the G-SIB's resolution strategy, whereas material-subgroups are formed by one or more direct or indirect subsidiaries of a resolution entity that meet certain criteria**

### Main concepts

#### Resolution entity

- Entity to which **resolution tools** will be applied in accordance with the **G-SIB's resolution strategy**.
- Depending on the strategy, a resolution entity may be a parent company, a subsidiary, etc. A G-SIB may have one or more resolution entities.

#### Resolution group

- It is formed by a **resolution entity and direct or indirect subsidiaries** of the resolution entity and that are not themselves resolution entities or subsidiaries of another resolution entity.

#### Material sub-group

- One or more **direct or indirect subsidiaries of a resolution entity** that:
  - i. Are not themselves resolution entities,
  - ii. Do not form part of another material sub-group of the G-SIB,
  - iii. Are generally incorporated in the same jurisdiction outside of their resolution entity's home jurisdiction; and
  - iv. Either on a solo or a sub-consolidated basis meet one of the criteria to be considered material<sup>1</sup>.

#### Single Point of Entry (SPE)

- SPE involves the application of resolution powers, for example, bail-in and/or transfer tools, at the **top parent or holding company level** by a **single resolution authority** – probably in the jurisdiction responsible for the global consolidated supervision of a group.

#### Multiple Point of Entry (MPE)

- MPE involves the application of resolution powers by **two or more resolution authorities to different parts of the group**, and is likely to result in a break-up of the group into two or more separate parts. The group could be split on a national or regional basis, along business lines, or some combination of each. The **resolution powers** applied to the separate parts **need not be the same**.

(1) The criteria to be considered material are: (i) have more than 5% of the consolidated RWAs of the G-SIB; (ii) generate more than 5% of the operating income of the G-SIB; (iii) have a total leverage exposure measure larger than 5% of the G-SIB consolidated leverage exposure; and (iv) have been identified by the CMG as material to the exercise of the critical functions.



## Annex 2

### Minimum requirement for own funds and eligible liabilities (MREL)

In December 2016, the EBA published a Report on the MREL, including among other aspects recommendations addressed to the Commission regarding its design. These recommendations are related to the denominator of the MREL requirement, the 'stacking order', etc.

#### EBA's Recommendations on the design of the MREL (1/3)

- 1 **Denominator of the MREL requirement**
  - It should be **changed from total liabilities and own funds (TLOF) to RWAs**. This should be complemented with a **leverage ratio exposure backstop**, in parallel with its phase-in within the capital framework.
- 2 **'Stacking order'**
  - Banks in the EU **should not be able to use the same CET1** capital to meet **MREL** and to meet regulatory capital buffers.
- 3 **Interaction between MREL and MDA**
  - It is recommended to introduce a **suspension** ('grace period') in the **automatic triggering of distribution restrictions** under the maximum distributable amount (MDA) framework where the breach relates to a **failure to roll over or issue sufficient MREL-eligible debt**.
  - This suspension could either arise automatically or on a discretionary basis following consideration of the circumstances by the resolution authorities (RAs). In both cases, the length of the grace period should be clearly specified and possibly be subject to a renewal decision by the authorities.
- 4 **Breach of MREL**
  - A breach of MREL should be treated as seriously as a breach of capital requirements. Thus, the EBA recommends, among others, that **powers of resolution authorities (RAs) should be enhanced** to respond to a breach of MREL, including:
    - The power to require the preparation and execution of an MREL restoration plan.
    - An expedited impediment removal process.
    - The power to request that distribution restrictions be imposed on the institution.
    - The power to request a joint restoration plan in cases where an institution breaches both MREL and minimum capital requirements.



## Annex 2

# Minimum requirement for own funds and eligible liabilities (MREL)

**Recommendations are also related to redemption and maturity management, cross-holdings of MREL, subordination...**

### EBA's Recommendations on the design of the MREL (2/3)

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#### Redemption and maturity management

- It is recommended to introduce an **approval requirement for any redemption** by an institution of an MREL-eligible instrument where that redemption would bring the institution into breach of its MREL requirement or the combined buffer requirement (CBR).
- Moreover, the legislative framework should contain a requirement for RAs to **monitor the maturity profile of the MREL-eligible instruments**, and RAs should be provided with explicit power to request an institution to **modify the maturity profile of its MREL stack**, when it constitutes an impediment to the resolvability of the institution.

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#### Cross-holdings of MREL

- Exposures to MREL instruments issued by credit institutions should be **deducted from MREL** on a like-for-like basis **above the double threshold** (in line with the proposal by the BCBS for the TLAC holdings). Moreover, holdings of senior instruments should only be deducted to the extent that they are eligible for MREL, unless the large exposure limit approach is adopted for issuances of non-G-SIBs.

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#### Subordination

- **G-SIBs** should meet their MREL with subordinated instruments at least to a level of **14.5% of RWAs** in line with the TLAC term sheet; and **O-SIBs** should meet a subordination requirement of **13.5% of RWAs**.
  - Regarding the subordination requirement to O-SIBs, the RAs should be provided with a power to adjust that requirement for an O-SIB on a case-by-case basis, taking into account the resolution strategy for the institution, the relevant debt market for that bank, and its liability structure.
- No particular form of subordination is recommended (subordination should be met with instruments subject to structural, statutory or contractual).



## Annex 2

# Minimum requirement for own funds and eligible liabilities (MREL)

...third-country recognition requirements, adequacy and calibration, intragroup issues, reporting and disclosure

### EBA's Recommendations on the design of the MREL (3/3)

- 8 Third-country recognition requirements**
  - Some **reduction of the burden of compliance with the third-country recognition requirements** should be introduced, which could be done by narrowing the scope of the requirement while maintaining the effectiveness of contractual recognition for MREL liabilities.
- 9 Adequacy and calibration**
  - The calibration of MREL should, in all cases, be closely **linked to and justified by the institution's resolution strategy**. **Business models** may be worth considering to the extent that they translate into differences in resolution strategies.
- 10 Intragroup issues**
  - The MREL framework should provide for the **identification of resolution entities** and the **allocation of internally issued, subordinated MREL** at the non-resolution-entity level.
- 11 Reporting**
  - The BRRD should provide for an **explicit obligation** for credit institutions to **regularly report** their level and composition of MREL instruments to RAs. In this regard, the EBA should be empowered to develop ITS laying down uniform rules and templates for the reporting of MREL-related data by credit institutions.
- 12 Disclosure**
  - Credit institutions in the EU should be required to **disclose the quantum and composition of their MREL-eligible liabilities** and the **MREL required by the RAs**.
  - In the transitional period, and pending finalisation of the BCBS recommendation in this area, credit institutions should be required to disclose to investors the quantum and composition of their stack of MREL-eligible liabilities, as well as information on the creditor hierarchy.



## Annex 2

### Minimum requirement for own funds and eligible liabilities (MREL)

The report also includes a quantitative analysis of the funding needs of 133 banking groups to meet the MREL, which range between €186bn and €276bn, and an analysis of the macroeconomic impact

#### Funding needs and macro-economic impact of MREL in the EU

##### Funding needs

- The EBA has estimated that the endorsement of MREL in the EU would required funding needs, for the 133 banking groups assessed, that range between **€186bn** (under the LA buffer<sup>1</sup> with partial subordination<sup>2</sup>) and **€276.2bn** (under the Buffer/8% scenario<sup>3</sup>, with partial subordination and partial recapitalisation for other banks).

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

##### Macroeconomic impact

- MREL benefits.** In the baselines scenario, assuming MREL reduces the probability of a crisis by 33% and the costs by 5.4%, the benefits would range between 23 and 92 basic points of GDP, depending on the discount rate, the length of the crisis, and its initial probability.
- MREL costs.** Under a partial subordination (for G-SIBs and O-SIBs) and a partial recapitalisation of 50% (for other banks), the costs are in the range of 0.6 to -6 bps, based on the macroeconomic model used, the MREL calibration level and the funding costs assumptions.
- Overall impact of introducing MREL.** Under the assumption of full market capacity to absorb MREL funding needs, MREL calibration level and eligibility criteria, the overall net benefits are positive and range between 17 and 91 bps of annual GDP.

(1) **LA buffer scenario.** Twice capital requirements + combined buffer requirement (CBR). Buffers are not included in the recapitalisation amount (RCA).

(2) **G-SIBs:** subordination 14.5% RWA + CBR. **O-SIBs:** subordination 13.5% RWA + CBR.

(3) **Buffer/8% scenario.** Higher of i) twice capital requirements + CBR; and ii) 8% of TLOF.

