KEY POINTS

- The Minimum Requirement for own funds and Eligible Liabilities (MREL) has been provided in order to prevent financial institutions from structuring their liabilities in such a way as to impede the effectiveness of the bail-in and of the other resolution tools.
- The resolution authorities set the MREL on a case-by-case basis and in accordance with the criteria provided by the Bank Recovery and Resolution Directive (BRRD) and the Regulatory Technical Standards.
- The eligible liabilaities included in the MREL are merely a subset of the liabilities that can be subject to the bail-in.
- The MREL is an additional requirement for financial institutions that must be met on top of the Basel III requirements.
- The MREL envisaged by the BRRD is consistent with the international framework provided by the FSB proposal of Total Loss-Absorbing Capacity (TLAC).

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Minimum requirement for own funds and eligible liabilities: its relationship with other regulatory requirements

The article explains the main characteristics and the criteria for setting the Minimum Requirement for own funds and Eligible Liabilities (MREL), its relationship with the bail-in-able liabilities, with the Basel III requirements and with the Total Loss-Absorbing Capacity (TLAC).

THE BANK RECOVERY AND RESOLUTION DIRECTIVE AND THE MREL

The MREL is a standard envisaged by the BRRD[1] which establishes a framework for the recovery and resolution of credit institutions and investment firms.

The MREL has been provided in order to prevent financial institutions from structuring their liabilities in such a way to impede the effectiveness of the bail-in and of the other resolution tools.

The MREL makes sure that financial institutions have sufficient loss absorbing capacity which ensures the continuity of the critical functions, the protection of the depositors and an orderly liquidation without recourse to public funds.

The MREL is merely envisaged by the BRRD because, on one side, the European Banking Authority is mandated to draft the technical regulatory standards which specify the criteria to determine the MREL,[2] and, on the other side, the MREL level is set by the relevant resolution authority on a case-by-case basis. Indeed, the MREL is not a fixed figure imposed by legislation but the resolution authorities are responsible for fixing it for each specific financial institution; they set an MREL that is adequate to the resolution plan of the specific institution.

Financial institutions must comply on an ongoing basis with the MREL and the relevant resolution authority is also empowered to monitor the compliance with such standard.

CONDITIONS AND CRITERIA FOR SETTING THE MREL

The liabilities can be classified as eligible liabilities provided that the following conditions are met: the instrument is issued and fully paid up; the liability is not owed to, secured by or guaranteed by the institution itself; the purchase of the instrument was not financed by the institution; the remaining maturity of the liability is longer than one year; and the liability is not related to a financial derivative or to a deposit with priority ranking in case of insolvency.

The resolution authorities are required to set the MREL having regard to a number of different criteria.

The MREL must ensure the resolvability of the institution, the applicability of the resolution tools, including the bail-in tool, and the pursuit of the resolution objectives.

The MREL must be set in accordance with the so-called capital adequacy criterion: however, the capital adequacy criterion comprises two components, the loss absorption and the recapitalisation. The first component (the loss absorption) relates to the need to ensure that the losses of the troubled institution can be absorbed by the institution itself. The second component (recapitalisation), in turn, consists of two parts: the first one relates to the need to ensure the compliance with the prudential rules whilst the second one relates to the need to ensure sufficient market confidence in the institution.

The MREL must be set at a sufficient level even if certain classes of liabilities are excluded by the resolution plan from the loss absorption and recapitalisation of the institution.

The MREL must be set also so as to take into account the contribution to the financing of the resolution that can be made by the deposit guarantee scheme.

The resolution authorities are required to fix the MREL also bearing other factors in mind such as the size, the business model, the funding model and risk profile of the institution.

In addition the MREL must be set in accordance with the so-called systemic risk criterion; the systemic risk criterion requires resolution authorities to assess the adverse effects on financial stability of the failure of the institution and its

Feature

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interconnectedness.

Some of the aspects that are assessed by the resolution authorities when they set the MREL are likewise assessed by the supervisory authorities when they calibrate the prudential regulatory requirements.

Relationship between the MREL and the bail-in-able liabilities

The MREL eligible liabilities do not correspond exactly to the bail-in-able liabilities. Indeed the MREL eligible liabilities are just a part of the liabilities that can be subject to the bail-in. According to the BRRD, the bail-in shall apply, without prejudice to the creditor hierarchy and the *pari passu* principle, to all liabilities that fall within its scope of application.

However, the application of the bail-in can be limited to the MREL eligible liabilities if the resolution authority, under exceptional circumstances, decides to exclude the other eligible liabilities.

RELATIONSHIP BETWEEN THE MREL AND THE BASEL III FRAMEWORK

Both the Basel III requirements and the MREL aim at ensuring stronger and more resilient banks and investment firms and, as a consequence, at fostering the stability of the banking system. However, the perspective of such requirements is significantly different. Indeed the Basel III requirements are provided for supervisory purposes while the MREL is provided for resolution purposes.

All EU banks and investment firms are subject to both the CRR/CRD IV, which implement the Basel III requirements in the European Union, and the BRRD, which provides for the MREL. Banks and investment firms are required to meet the MREL on top of the Basel III requirements. The MREL and the Basel III requirements do not exclude the application of each other. In other words the MREL represents an additional requirement to the ones provided under the Basel III framework.

Obviously, many of the instruments that can be classified as Tier 1, Additional Tier 1 and Tier 2 under the Basel III framework are also suitable for inclusion in the MREL. Nevertheless the resolution authorities are empowered to identify those instruments that, even though they are relevant for supervisory purposes, cannot be included in the MREL.

RELATIONSHIP BETWEEN THE MREL AND THE TOTAL LOSS-ABSORBING CAPACITY

Both the MREL and TLAC pursue the same objective to ensure that banks comply with certain minimum standards and, ultimately, to ensure the effectiveness of the resolution. Nevertheless there are many differences between the MREL and the TLAC outlined below.

The first difference regards the scope of application: indeed, the TLAC is a global standard set by the Financial Stability Board (FSB)[3] and potentially applicable in any FSB member jurisdiction; the MREL, instead, is a requirement provided for EU financial institutions and therefore it is a regional standard. Furthermore the TLAC standard is designed just for global systemically important banks whilst the MREL is applicable to all banks.

The TLAC is determined in relation to the risk-weighted assets and to the leverage; the MREL, instead, is defined in terms of liabilities and own funds.

In addition, the TLAC represents a minimum requirement that is identical for all banks[4] whilst the MREL is set by the relevant resolution authority on an individual basis having regard to the characteristics and structure of the specific bank and to its resolution plan. ■

1 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

2 See: EBA Final Draft Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU, 3 July 2015.

3 See: Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution, TLAC Term Sheet, 9 November 2015.

4 The minimum TLAC requirement is set at 16%/18% of the risk-weighted assets and at 6%/6.75% of the Basel III leverage ratio denominator.

Further Reading:

- Fewer options for capital-raising by banks: more stability? [2015] 11 JIBFL 671.
- Revolution in resolution: loss-absorption, recapitalisation and restructuring of distressed banks [2015] 1 JIBFL 34.
- LexisPSL: Financial Services: About MREL.