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Commission services' note on elements of the CMDI package related to MREL calibration for transfer strategies

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1. Background

In the current framework, the rules on MREL calibration are primarily focused on open bank bail-in, with little guidance for resolution authorities on the calibration for transfer strategies. In the context of the 2019 Risk Reduction Package, detailed rules governing MREL calibration were moved from Delegated Regulation (EU) 2016/1450 into the BRRD and the SRMR. The main goal of the legislative work back then was to ensure a reconciliation of the MREL framework with the TLAC standard, applicable to global systemically significant institutions and, therefore, primarily designed to ensure the success of an open bank bail-in.

As a result, the provisions introduced in the BRRD and SRMR in 2019 laid down a methodology that was very detailed in the case of institutions and entities with an open bank bail-in as preferred resolution strategy while providing less legal certainty in the case of transfer strategies. Concretely, Articles 45c (1) and 45c (2) BRRD¹ set down general principles governing MREL-setting. In addition, Articles 45c (3) (a)(ii) and (b)(ii) BRRD², governing the exact calibration of external MREL, only refer to “*a recapitalisation amount that allows the resolution group resulting from resolution to restore compliance with its [pillar 1 and pillar 2 capital requirements, or leverage ratio requirement] at the consolidated resolution group level after the implementation of the preferred resolution strategy*”. Consequently, if the resolution strategy is open bank bail-in, the rule is in effect prescriptive. If the resolution strategy chosen is a transfer, resolution authorities have discretion on how to calibrate that requirement, in function of the characteristics of the transfer transaction.

In availing themselves of this discretion, resolution authorities across the Union have developed their own policies, suited to the needs and specificities of their banking sectors. For example, the Single Resolution Board (SRB) takes a top-down approach, starting from the calibration applicable to open bank bail-in and then reflecting the effect of the transfer strategies³, recognising that full

¹Mirrored in Articles 12d (1) and (2) SRMR.

² Mirrored in Articles 12d(3)(a)(ii) and (3)(b)(ii) SRMR.

³ SRB (May 2023), [Policy on minimum requirement for own funds and eligible liabilities](#), (section 2.4.2, p.14-15, for MREL calibration for transfer strategies)

recapitalisation will likely not be needed in such cases. The Danish Financial Supervisory Authority takes a bottom-up approach starting from the amount needed to absorb losses and increasing it to reflect the estimate of the losses on assets that would not be transferable to a buyer⁴.

Against this background, the CMDI proposal explicitly recognises the difference between open bank bail-in strategies and transfer strategies with regard to MREL calibration, thereby (i) providing legal certainty around the different practices that have been developed over time in Member States and (ii) taking into account the specificity of transfer strategies.

The Commission is of the view that funding needs in case of transfer strategies are much more case-dependent than in the case of open bank bail-in strategies and that a one-size-fits-all approach would therefore not be appropriate. It therefore proposes a list of guiding principles for setting MREL in case of transfer strategies leading to a market exit, which is designed to preserve the diversity of existing policies within the Union as well as the necessary flexibility while ensuring a more explicit legal recognition for transfer strategies, rather than a detailed methodology for the calibration of MREL as that was deemed better suited for the internal policies of each resolution authority.

2. New provisions proposed

2.1. MREL calibration for transfer strategies in resolution (paragraphs 1 and 3 of Article 45ca BRRD)

Under the Commission's proposal, a new Article 45ca in BRRD, mirrored in a new Article 12da SRMR, lists the five following criteria on which the calibration of MREL for transfer strategies in resolution leading to market exit must be based:

- (a) the resolution entity's size, business model, funding model and risk profile, and the depth of the market in which the resolution entity operates;*
- (b) the shares, other instruments of ownership, assets, rights or liabilities to be transferred to a recipient as identified in the resolution plan, taking into consideration:*
 - (i) the core business lines and critical functions of the resolution entity;*
 - (ii) the liabilities excluded from bail-in pursuant to Article 44(2);*
 - (iii) the safeguards referred to in Articles 73 to 80;*
- (c) the expected value and marketability of the shares, other instruments of ownership, assets, rights or liabilities of the resolution entity referred to in point (b), taking into account:*
 - (i) any material impediments to resolvability, identified by the resolution authority, that are directly related to the application of the sale of business tool or the bridge institution tool;*

⁴ Danish FSA (October 2017), [Resolution strategy and MREL for small and medium-sized banks](#) and [Principles for setting MREL for smaller institutions](#).

- (ii) *the losses resulting from the assets, rights or liabilities left in the residual institution;*
- (d) *whether the preferred resolution strategy envisages the transfer of shares or other instruments of ownership issued by the resolution entity, or of all or part of the assets, rights and liabilities of the resolution entity;*
- (e) *whether the preferred resolution strategy envisages the application of the asset separation tool.*

Those criteria ultimately aim to assess the two main elements that influence the financing needs of any transfer strategy, namely:

- 1) The planned transfer perimeter, i.e., what is to be transferred (point (b)). It should correspond as a rule to the critical functions and core business lines (which are respectively what is to be preserved in resolution and what will be attractive to a buyer), subject to the existing legal safeguards. It is also related to the type of strategy chosen (points (d) and (e)) since some tools are by their nature associated to a specific perimeter (e.g., share deals, which cover the whole institution, or transfer of only part of the assets, or asset deals with a transfer of rights and liabilities with or without the use of the asset separation tool).
- 2) The likelihood of success of the transfer at the time of resolution (captured by the elements set out in point (c)), that is also influenced by the characteristics of the specific institution concerned (point (a)).

Since this Article applies only in the case of transfer strategies leading to market exit, there would be no justification for setting on its basis an MREL that would be higher than in situations where the continuation of the business after resolution is envisaged, not least because the necessary recapitalisation amount should be lower. To ensure this outcome, paragraph 3 of Article 45ca BRRD specifies that the application of paragraph 1 of Article 45ca shall not result in an amount that is higher than the amount resulting from application of Article 45c (3).

Finally, to ensure that enough MREL resources, that constitute the first line of defence, will always remain available, the potential contribution of the DGS in resolution is not part of the proposed criteria and recital 30 of the proposal amending BRRD specifies that the resolution authorities should not consider such a possible intervention when calibrating the MREL.

2.2. MREL calibration for transfer strategies in insolvency with DGS support (paragraph 2 of Article 45ca BRRD)

Some Member States have exercised the option provided in Article 11(6) DGSD to provide for the use DGS funds for transfers in the context of national insolvency proceedings. The economic effect of such a measure would be equivalent to a transfer in resolution leading to market exit under the revised BRRD as proposed by the Commission. In both cases, the entity under resolution ceases to exist as such and some of its activities, including the taking of deposits, are transferred to a third party. Both strategies also imply that there are important economic

functions to be preserved in the entity and are chosen because they are more cost effective or better preserve financial stability than a piecemeal liquidation. Such preservation requires sufficient funding.

As a result, it would not be appropriate to have MREL set differently in those two economically equivalent situations.

Under Article 45c(2a), second subparagraph, BRRD⁵, resolution authorities are also able to set a MREL for liquidation entities that exceeds the loss absorption amount, where this is assessed as necessary for the objectives of protecting financial stability or limiting potential contagion to the financial system.

Therefore, in case the resolution plan of a liquidation entity provides for it to be wound up under normal insolvency proceedings or other equivalent national procedures and envisages the use of the deposit guarantee scheme pursuant to Article 11(5) DGSD⁶, the Commission proposes, in the second paragraph of Article 45ca BRRD, to require the resolution authority to increase the MREL above the amount necessary to absorb losses on the basis of Article 45c(2a) BRRD and, when doing so, to apply the same methodology as when setting MREL for a transfer in resolution, i.e. the one set out in the first paragraph of Article 45ca.

3. Potential impacts

According to the SRB MREL dashboard for the first quarter of 2023, the average MREL target for banks for which the preferred resolution strategy was open bail-in was 27.4% TREA, while for banks for which the preferred resolution strategy was a transfer tool, the average MREL was 23.6% TREA.⁷

Therefore, the current proposal does not aim to decrease MREL levels within the EU banking sector because it only aims to provide more detailed legal basis for existing practices. As explained above, for the purpose of legal certainty and convergence of practices, the proposal only lays down principles that should guide authorities when setting MREL for transfer strategies and does not introduce elements that could lead to a decrease in MREL levels for individual banks with a transfer strategy.

Moreover, from a system-wide perspective, under the CMDI more institutions and entities should build-up MREL above the loss absorption amount when they move from a liquidation strategy to a resolution strategy. This could achieve stronger MREL levels within the system overall. Finally, going forward, although unrelated to the review of the crisis management and deposit insurance framework, the implementation in the Union of the international agreement on the finalisation of Basel III will also have indirect effect on MREL levels by affecting prudential

⁵ Put forward in the separate Daisy Chains proposal and mirrored in Article 12d(2a) SRMR.

⁶ New numbering of the former Article 11(6)

⁷ Single Resolution Board (August 2023), [SRB MREL dashboard Q.1 2023](#), (p.6)

requirements. The effect of this implementation should therefore also be factored in for a proper estimate of the evolutions of MREL levels in the coming years. The analysis of EU-specific adjustments annexed to the European Banking Authority (EBA) report on Basel III monitoring estimated an increase of the Tier 1 minimum required capital by 11.5% overall - 12.7% for large and internationally active banks, of which 18% for G-SIIs, and 5.7% for other banks- in the EU as a result of implementing the finalisation of Basel III in the EU, taking into account existing EU specificities and adjustments to the international framework that were part of the Commission's proposal⁸. Those capital increases will translate into MREL increases in the coming years.

⁸ EBA (September 2022)

https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2022/Basel%20III%20monitoring%20report/1039929/Annex%20-%20EU%20specific%20analysis.pdf, p.24-25