FACT SHEET

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Fact-sheet on the minimum requirements for own funds and eligible liabilities (MREL) for systemically important banks

FINANCIAL SUPERVISORY AUTHORITY
Århusgade 110
DK-2100 København Ø

Tel. 33 55 82 82
Fax 33 55 82 00
CVR no. 10 59 81 84
finanstilsynet@ftnet.dk
www.finanstilsynet.dk

MINISTRY OF INDUSTRY, BUSINESS AND FINANCIAL AFFAIRS

The purpose of MREL

The purpose of MREL is to ensure that resolution of banks is possible without the use of public funds. The strategy for systemically important banks, is for the *entire* institution to continue. This is because for systemic banks, unlike small and medium-sized banks, you cannot plan for the possibility to sell off significant parts of the bank in a crisis situation. Furthermore, crises that involve systemically important banks could have serious consequences on the real economy and on financial stability. Therefore, for these banks, more own funds and eligible liabilities are needed to ensure that crisis management can take place without using public funds.

Level of MREL

Since it is necessary for SIFIs to continue all the group's activities after crisis management as viable, these groups will receive MREL that are significantly higher than the requirements for small and medium-sized banks. In order to be able to continue all activities, the Financial Supervisory Authority determines MREL to be twice the capital requirements (solvency requirement plus the combined capital buffer requirement). The reason for the double capital requirements is that there must be adequate own funds and liabilities to absorb the losses as well as to recapitalise the group. The loss absorption amount must correspond to the losses that the group should be able to absorb. The recapitalisation amount must ensure that it is possible to carry out the selected strategy of viable continuation of the group after crisis management, i.e. that the group can be recapitalised to a level that can fulfil capital requirements and maintain adequate market confidence.

The MREL exemption for mortgage credit institutions

Mortgage credit institutions are exempt from MREL. Due to this exemption, mortgage credit institutions are not included in the consolidation when determining MREL for groups that include both banks and mortgage credit institutions. The calculation of the risk exposure amount to be used for determining MREL therefore does not contain the risk exposure amount in mortgage credit institutions. However, the calculation does take into account the exposures that the other part of the group has towards the mortgage credit institution, e.g. through ownership, guarantees, mortgage bond holdings, etc.

Instead of MREL, mortgage credit institutions must fulfil a so-called debt buffer requirement of 2 percent of their unweighted loans, in addition to their existing capital requirement.

Because the mortgage credit activities are exempt from MREL, liabilities and own funds cannot be used to both fulfil MREL and the debt buffer and capital requirement, which applies to the group's mortgage credit institution(s).

In the box below, you can find an example of how MREL is calculated for groups, which include both a bank and a mortgage credit institution.

Example: MREL for a group with both a bank and a mortgage credit institution

The example assumes that:

- A bank owns a mortgage credit institution (beyond its other subsidiaries)
- The group's risk exposure amount (REA): DKK 200 billion
- The mortgage credit institution’s REA: DKK 50 billion
- The bank's exposures to the mortgage credit institution:
    - Equity: DKK 12 billion
    - Mortgage bonds. DKK 30 billion (assumed risk weight: 10 percent)
    - Guarantees issued by the bank to the mortgage credit institution: DKK 30 billion (assumed risk weight: 50 percent)
- Capital requirements for the mortgage credit institution: DKK 6 billion
- Debt buffer requirement for the mortgage credit institution: DKK 4 billion.

Liabilities and own funds used to fulfil the total debt buffer and capital requirement for the mortgage credit institution (DKK 10 billion) cannot be used to simultaneously fulfil the MREL-requirement, and it therefore constitutes a deduction in the calculation of the MREL funds. Equity exposures beyond the DKK 10 billion are risk weighted 100 percent.

The risk exposure amount for the group excluding mortgage credit is calculated to:

REA in the group:	**DKK 200 billion**
minus REA in mortgage credit institution (MCI)	- DKK 50 billion
plus equity in MCI beyond capital and debt buffer requirement	+DKK 2 billion (12 - 10)[1]
plus risk exposure amount for mortgage bonds	+ DKK 3 billion
plus risk exposure amount for guarantees	+ DKK 15 billion
REA in the group excluding mortgage credit:	**DKK 170 billion**

Due to the exemption for mortgage credit institutions from MREL, the risk exposure amount that MREL is based on must be "cleaned" of mortgage credit. MREL is thus set, based on the risk exposure amount excluding mortgage credit, i.e. DKK 170 billion. If MREL is calculated at 30 percent, this results in a requirement of DKK 51 billion. The mortgage credit institution is exempted from MREL, but must comply with a debt buffer requirement. A group may not count twice the liabilities and own funds that are used to comply with MREL and the debt buffer requirement. Therefore, the requirements for the mortgage credit institution of DKK 10 billion cannot be fulfilled with the same liabilities and own funds that are used to fulfil MREL. The total requirements for the group (MREL for banking activities and capital and debt buffer requirements for mortgage credit activities) thus equal DKK 61 million.

[1] When the capital requirements and the debt buffer requirements have been fulfilled, there is an excess equity of DKK 2 billion. It is assumed that these are intragroup exposures.

The total requirements must equal at least 8 percent of the group's total liabilities including own funds

On 14 March 2018, a legislative proposal was submitted that would lead to an increase in the debt buffer requirement, so that the total requirements for the groups would always constitute at least 8 percent of the total liabilities including own funds. This ensures that all the groups have sufficient liabilities and own funds that can contribute towards financing in a crisis management situation, and ensures that the requirements for the Danish groups conform to the requirements that apply internationally. The 8 percent requirement will come into effect on 1 January 2022.

MREL eligible liabilities and own funds bear losses before senior unsecured creditors

It is critical for the credibility of the resolution plans that it is not assumed in the resolution plan that write-down or conversions of other unsecured claims must take place, which include deposits above the deposit guarantee limits. To enable this, the Financial Supervisory Authority requires that only liabilities and own funds that bear losses before other senior unsecured claims in resolution as well as insolvency can be included in the calculation for the fulfilment of MREL (subordination).

Even though the subordination requirement significantly reduces the risk of losses for senior unsecured creditors, there is still the risk that losses in connection with crisis management could be so large that senior unsecured creditors would suffer losses in connection with the crisis management.

On 14 March 2018, a proposal was submitted to introduce a new layer in the creditor hierarchy – so-called non-preferred senior debt – for financial companies, so that the institutions can begin issuing the subordinated MREL instruments.

Phasing-in

MREL constitutes a considerable supplement to the existing capital requirements. However, most SIFIs have adequate capital and senior debt instruments to be able to fulfil the MREL. However, the requirement for subordination will only be fulfilled as the existing senior debt matures and the institutions replace it with non-preferred senior debt.

The Financial Supervisory Authority has therefore decided on the following phasing-in of MREL:

- MREL must be fulfilled by 1 July 2019.
- Debt issued before 1 January 2018 – which fulfils all the criteria for MREL eligible liabilities and own funds, with the exception of the requirement for subordination – can be included in the fulfilment of the institutions' MREL until 1 January 2022.