European Parliament

Amending the EU bank resolution framework – BRRD and SRMR

OVERVIEW

In May 2019, the European Parliament and the Council adopted the proposals amending the EU legislative framework on bank resolution, consisting of the Banking Recovery and Resolution Directive, and the Single Resolution Mechanism Regulation. Resolution is the restructuring of a bank which is failing or likely to fail, aiming at safeguarding continuity of the bank's critical functions, preserving financial stability and minimising rescue costs to taxpayers. The adopted amendments incorporate into EU law the Total Loss-Absorbing Capacity standard, set at international level to improve large financial institutions' capacity to absorb losses and recapitalise in case they are placed in resolution. The new legislative texts were published in the Official Journal on 7 June 2019, and come fully into force on 28 December 2020.

Proposal for a directive of the European Parliament and of the Council amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms and amending Directive 98/26/EC, Directive 2002/47/EC, Directive 2012/30/EU, Directive 2011/35/EU, Directive 2005/56/EC, Directive 2004/25/EC and Directive 2007/36/EC; Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms

Committee responsible:	Economic and Monetary Affairs (ECON)	COM(2016) 851
Rapporteur:	Gunnar Hökmark (EPP, Sweden)	COM(2016) 852
		23.11.2016
Shadow rapporteurs:	Pedro Silva Pereira (S&D, Portugal); Syed Kamall (ECR, United Kingdom); Thierry Cornillet (ALDE, France); Martin Schirdewan (GUE/NGL, Germany); BRRD: Philippe Lamberts (Greens/EFA, Belgium); SRMR: Ernest Urtasun (Greens/EFA, Spain); Marco Valli (EFDD, Italy); Marco Zanni (ENF, Italy)	2016/0361(COD) 2016/0362(COD)
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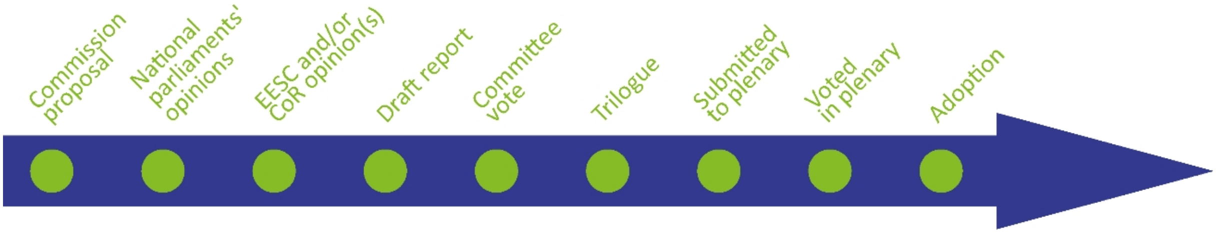

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Author: Carla Stamegna

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Introduction

In November 2016, the European Commission presented a comprehensive 'banking reform package' including proposals to amend the EU legislative framework on bank recovery and resolution. The EU's resolution framework has been in place since 2014, however recent international policy developments made adjustments necessary. The major objective of the Commission's proposals is to incorporate into EU law international standards on large financial institutions' capacity to absorb losses and recapitalise in case they are placed in resolution.

Context

Resolution is the restructuring of a bank which is failing or likely to fail through specific measures ('resolution tools') aimed at safeguarding the continuity of the bank's critical functions, preserving financial stability and minimising rescue costs to taxpayers, in the public interest. Resolution authorities are charged with overseeing the application of the appropriate resolution regime to a failing bank.

In view of the massive amount of public money that many EU countries had to inject into their banking systems to rescue banks in the wake of the 2008 financial crisis, the Financial Stability Board (FSB) published a document setting out the key attributes of effective resolution regimes in 2011; these were later endorsed by the G20 as 'a new international standard for resolution regimes'. The key attributes establish the core elements for an orderly resolution of distressed financial institutions that preserve the continuity of vital functions while minimising costs for taxpayers. These standards were incorporated into EU law in 2014, through the Banking Recovery and Resolution Directive (BRRD).

Further developments in this area affect the capacity of global systemically important banks (G-SIBs) to absorb losses and recapitalise in case of resolution. In this respect, on 9 November 2015, the FSB published the Total Loss-Absorbing Capacity (TLAC) standard, endorsed a week later by the G20. The **TLAC standard** compels G-SIBs to hold a minimum amount of financial instruments and liabilities readily available for absorbing losses and recapitalising within resolution; however it does not limit resolution authorities' powers to impose that losses are absorbed by writing down further liabilities. Aimed at addressing the 'too-big-to-fail' issue and reducing the impact of large bank failures on public funds and financial stability, the TLAC standard should apply to all G-SIBs (currently 29 banks worldwide, including 11 within the EU) as of January 2019. G-SIBs should meet the TLAC requirement alongside the minimum capital requirements set out in the Basel III framework. In particular, they should hold a minimum amount of eligible instruments (including instruments that count towards satisfying minimum capital requirements, subject to certain conditions) equal to at least 16 % of risk-weighted assets (RWAs) (**TLAC RWA Minimum**) **and** to 6 % of the leverage ratio exposure (LRE), which is the denominator used to calculate the leverage ratio as per the relevant Basel III standard (**TLAC LRE Minimum**). As of January 2022, those thresholds will be set at 18 % and 6.75 % respectively. The standard should be read in conjunction with the principles set in the September 2013 report on 'Progress and next steps towards ending "Too-Big-To-Fail" (TBTF)'. Since the TLAC standard is not legally binding, it has to be transposed into law. So far, the Capital Requirements Directive IV (CRD IV) only established criteria to define 'global systemically important institutions (G-SIIs)' (Article 131(1)), the EU equivalent of G-SIBs.

Existing situation

The Banking Recovery and Resolution Directive (BRRD) introduced rules of minimum harmonisation in Member States' national laws by setting out common tools for the prevention and resolution of crises of banks and certain investment firms. For Member States participating in the Banking Union, this framework is completed by a regulation establishing a Single Resolution Mechanism (SRMR).

Bank Recovery and Resolution Directive (BRRD)

The BRRD establishes an integrated approach for managing banking crises. While transposing the FSB's key attributes of effective resolution regimes into EU law, the directive aims to: (i) preserve financial stability, ensuring the continuity of banks' critical functions in the public interest; (ii) minimise the resolution costs for taxpayers, by involving the private sector in the resolution (burden-sharing); (iii) create a level playing field among Member States; (iv) avoid disordered, and therefore more costly, failures.

Firstly, the directive sets out tools aimed at preventing financial institution distress. In this respect, it requires (i) financial institutions to prepare recovery plans envisaging measures to be taken in the event of financial difficulties; (ii) supervisory authorities to review and approve these plans; (iii) resolution authorities to lay down resolution plans in the event of an institution's failure. Secondly, the BRRD provides competent authorities with early intervention powers, so that they can step in when the viability of a financial institution is at risk but the point of failure has not yet been reached. Finally, the directive lays down resolution tools to be activated by resolution authorities when a financial institution is failing or likely to fail, when no alternative solution is workable and when it is in the public interest to place the institution in resolution rather than insolvency.

To limit state aid for ailing institutions, the resolution tools include a bail-in mechanism (Articles 43 ff. BRRD), which consists of writing down a bank's debt or converting debt claims or other liabilities into equity for a **minimum amount of 8 % of total liabilities and own funds (TLOF),** according to a pre-defined hierarchy, before the resources set aside to help finance the cost of the resolution (resolution fund) can be tapped (Article 44(5)) or other resolution tools activated. To ensure that sufficient financial instruments are available for write-down or conversion into equity, the BRRD (Article 45) requires resolution authorities to set, on a case-by-case basis, the **minimum requirement for own funds and eligible liabilities (MREL)** that financial institutions have to meet.

The TLAC standard and the MREL share the same **objective**, but differ in many aspects. Firstly, in terms of scope, TLAC being designed only for systemically important institutions, whereas MREL applies to all EU banks. Secondly, TLAC is calculated towards RWAs, while the MREL is expressed as a percentage of institutions total liabilities including regulatory capital (TLOF). Thirdly, the minimum TLAC requirement should be met in principle with subordinated debt instruments designed to be bailed-in before other liabilities that could be excluded from the application of bail-in; for the purposes of MREL, on the contrary, subordination of debt instruments is not mandatory but could be required by resolution authorities on a case-by-case basis to the extent bailed-in creditors are not treated worse than in a hypothetical insolvency scenario (no-creditor-worse-off (NCWO) principle). Finally, TLAC is conceived as a common minimum requirement (said Pillar 1 requirement, in analogy with the 'Basel II' three-pillar architecture), while the MREL is a bank-specific (Pillar 2) requirement set by resolution authorities on a case-by-case basis. However, the BRRD gave the European Commission the mandate, if deemed appropriate, to adopt a legislative proposal on revisions to the MREL by 31 December 2016, including the possibility of introducing a common minimum level of MREL and the need to ensure it is consistent with standards developed at international level, including TLAC.

Single Resolution Mechanism Regulation (SRMR)

The SRMR established the Single Resolution Mechanism (SRM), which complements the Single Supervisory Mechanism (SSM) as the second pillar of the banking union and aims to manage swiftly and in orderly fashion possible crises of larger institutions in the euro area and other participating Member States. The SRM includes a central resolution authority, the Single Resolution Board (SRB), and a Single Resolution Fund (SRF) financed by ex-ante contributions from the financial industry. The target level of the SRF to be reached by 2024 amounts to 1 % of the covered deposits of all banks in participating Member States, i.e. about €55 billion. In 2017, the SRB developed its MREL policy and adopted its first binding decisions for major banking groups. The SRB published an update to its policy in light of the adoption of the banking package, in June 2019.

Parliament's starting position

The European Parliament addressed the topic of loss absorption and recapitalisation in bank resolution in several statements, inter alia in its annual report on the banking union in 2015, where it called for 'timely progress to be made in drawing up resolution plans and setting a minimum requirement for own funds and eligible liabilities (MREL)', and to prioritise systemically important institutions. Parliament also called on the European Commission to swiftly adopt the regulatory technical standard (RTS) on MREL, with a high binding standard of at least 8 % MREL for all SRB banks, in line with the BRRD. It noted the ongoing work on the implementation of TLAC and called on the Commission to ensure consistency with MREL. In view of a comprehensive review of the Basel III framework, initiated by the Basel Committee on Banking Supervision in 2012, Parliament adopted a resolution on the finalisation of Basel III on 23 November 2016. It pointed out 'the interaction of the prudential requirements for banks with other major banking standards, such as the introduction of the TLAC standard within the EU and its harmonisation with the MREL requirement under the BRRD ...'.

Council starting position

In its June 2016 conclusions on the roadmap to complete the banking union, the Economic and Financial Affairs Council (ECOFIN) stressed the importance of pursuing risk reduction and risk sharing measures in the financial sector and invited the European Commission to put forward legislative proposals to this effect no later than the end of 2016. Amendments to the legislative framework were proposed in view of the implementation of the TLAC standard and the review of the MREL. The Council sought consistent rules and adequate amounts of financial instruments to write down or convert for all credit institutions for which bail-in would be the validated resolution strategy.

Preparation of the proposals

On 23 May 2016, the European Commission adopted delegated regulation (EU) 2016/1450 incorporating the bulk of the draft regulatory technical standards (RTS) issued by the European Banking Authority (EBA) on 3 July 2015, which specified the criteria for resolution authorities (RAs) on how to set MREL. Before the final adoption of the delegated regulation, the EBA conveyed a dissenting view regarding some amendments proposed by the Commission to draft RTS, arguing that, even if the RTS cannot set a harmonised level of MREL, legal clarity and certainty was needed when setting MREL for a systemic institution which may need to access resolution funds. In addition, the EBA disagreed with the proposed removal of provisions on the consultation between supervisory and resolution authorities on specific matters, and of the upper limit on the transitional compliance period, arguing that those amendments would reduce the effectiveness of the RTS in promoting smooth cooperation and convergence when setting MRELs. The EBA delivered further analysis on the implementation of the MREL in its report of 14 December 2016.

In its November 2015 communication on completing the banking union, the Commission indicated that, in considering the findings of a report published by the EBA under Article 45(19) of the BRRD, it might submit a legislative proposal on the harmonised application of the MREL by end-2016, so that in this context the TLAC standard could be implemented into the EU by the agreed deadline of 2019.

The Commission carried out an assessment of the existing financial services framework to ensure recent reforms interact smoothly, both with each other and with new policy initiatives as well as with broader reforms in the financial sector. This broad assessment, which includes a public consultation known as the Call for Evidence, also took global standards and their impact on the wider economy into account.

On 23 November 2016, the Commission published an impact assessment covering the overall banking reform package, including the revision of the BRRD and the SRMR. In the view of the Commission, the proposal rectifies several MREL shortcomings: MREL calibration conditions and eligibility criteria for liabilities; clarifying internal loss-absorbing capacities within banking groups; as well as aligning the basis for calculation on the RWA and the LRE measure. The impact assessment's main strengths, as singled out in an initial appraisal carried out by EPRS, appear to be: thorough research, tying in with relevant international work strands, notably by the Basel Committee on Banking Supervision, the FSB and the European Banking Authority; an extensive consultation process; a structured approach; and the monitoring indicators, which should help evaluation. The main weaknesses concern the limited analysis devoted to twelve apparently important areas, relegated to an annex.

The changes the proposals would bring

Against the background outlined above, the Commission presented a review of the current resolution framework as part of a comprehensive 'banking reform package', on 23 November 2016. The proposed amendments aim to transpose the TLAC standard into EU law and incorporate it, as appropriate, into MREL to prevent duplication that would be caused by potential parallel application of these two requirements. To this aim, a **Pillar 1 MREL**, requiring G-SIIs to hold harmonised minimum levels of own funds and other instruments (eligible liabilities) suitable for bearing losses in resolution, in compliance with the TLAC standard, would be set by amending the Capital Requirements Regulation (CRR).[1] A new chapter concerning eligible liabilities is added to the CRR following the chapters governing own funds. A bank-specific add-on for G-SIIs and the MREL for non-G-SIIs (**Pillar 2 MREL**) would be introduced through a proposal for a directive amending the BRRD and a proposal for a regulation amending the SRMR.

The review of the resolution framework is complemented by further amendments to the BRRD concerning the ranking of unsecured debt instruments in insolvency hierarchy, which were laid down in a separate proposal to allow for a fast-track adoption.[2]

The main details of the proposals are:

Amendments to the Capital Requirements Regulation (CRR)

Pillar 1 MREL-TLAC

The new 'Pillar 1 MREL', which would implement TLAC into EU legislation, would be calculated as a percentage of a risk-based denominator (total risk exposure amount, TREA, which is the transposition into EU law of the concept of RWAs), and a non-risk-based denominator (leverage ratio exposure measure, LREM) (new Article 92a of the CRR), which would apply only to G-SIIs. The amended Article 6 of the CRR would require stand-alone G-SIIs that are resolution entities (see below) to comply with the Pillar 1 MREL on a stand-alone basis, whilst according to the amended Article 11, resolution entities that are part of groups designated as G-SIIs would have to comply with the requirement on a consolidated basis.

A new Chapter 5a (new Articles 72a-72l, CRR) on eligible liabilities would be introduced. It includes the list of liabilities that cannot qualify as eligible for the purpose of compliance with the MREL and lays down eligibility criteria for items qualifying as eligible liabilities. The Commission proposed that Pillar 1 MREL requirements should be met with subordinated instruments. However, it also specified the conditions where non-subordinated debt may be used to meet the requirement. Finally, the new Chapter 5a sets out that instruments may count towards eligible liabilities only as long as their residual maturity equals at least one year.

Amendments to the Banking Recovery and Resolution Directive (BRRD)

Pillar 2 MREL

For non-G-SIIs, the MREL would remain a bank-specific (Pillar 2) requirement set on a case-by-case basis by the relevant resolution authority when preparing resolution plans. The amended Article 45 of the BRRD aligns the measurement of the Pillar 2 MREL with those used for the Pillar 1 MREL, as per the TLAC standard. Therefore, the Pillar 2 MREL would be expressed as a percentage of the TREA and the LREM of the relevant institution. The new Article 45b would align the eligibility criteria for the instruments that could count for meeting the Pillar 2 MREL requirements with those provided for the Pillar 1 MREL, with the exception of the subordination. Article 45b further specifies that subordination could be required by RAs to the extent it is needed to facilitate the application of the bail-in. Article 45c details the criteria to be used by RAs for determining the Pillar 2 MREL for all banks; it broadly reflects Delegated Regulation 2016/1450 for setting MREL (see 'Preparation of the proposal'). Pillar 2 MREL is to be calibrated to cover (i) the loss absorption equivalent to prudential capital requirements and (ii) recapitalisation requirements that would enable a bank to meet its authorisation requirements after resolution.

In Article 45d, the Commission proposes that RAs should be able, on the basis of bank-specific assessments, to also require G-SIIs to comply with a supplementary Pillar 2 MREL requirement where the Pillar 1 MREL is not sufficient to absorb losses and recapitalise a G-SII under the chosen resolution strategy.

Banks will be allowed to use certain additional types of highly loss absorbent liabilities to comply with their Pillar 2 MREL as long as a bail-in of such liabilities in resolution would not result in a treatment of creditors that is worse in comparison to their treatment under insolvency (NCWO principle).

Consequences of breaching the MREL

In line with the TLAC standard, the Commission's proposal would require that, in case an institution does not have sufficient eligible liabilities to comply with its MREL, the resultant shortfall is automatically completed using Common Equity Tier 1 (CET1), which, until that moment, was counted towards meeting the combined capital buffer requirement under the CRD IV. In turn, this may cause a breach of the combined capital buffer requirement, and subsequent restrictions to distribution of profits to the holders of certain regulatory capital instruments and employees (maximum distributable amount (MDA)). Breaches of the combined buffer (while still complying with its Pillar 1 and Pillar 2 capital requirements) may be due to a temporary inability to issue new eligible debt for MREL. For these reasons, the proposal envisages a six-month grace period before restrictions to profit distribution take effect.

MREL guidance

In line with the proposal to amend the CRD IV clarifying the distinction between Pillar 2 capital requirements addressing institution-specific actual risks and Pillar 2 capital guidance aimed to face forward-looking and remote stresses, new Article 45e of the BRRD would apply the concept of 'guidance' also to the MREL framework. In particular, it would allow RAs 'to require institutions to meet higher levels of MREL to cover losses exceeding those expected under a standard resolution scenario, while addressing in a more flexible manner any breaches of those levels, in particular by relieving the automatic restrictions on MDA'. The MREL guidance should be calibrated to include a 'market confidence buffer' (MCB) necessary to ensure market confidence post-resolution.

Level of application of the MREL

Both the BRRD and the TLAC standard recognise Single Point of Entry (SPE) and Multiple Point of Entry (MPE) resolution strategies. Under the SPE strategy, only one entity of the group (usually the parent) is resolved, whilst other entities of the same group (usually operating subsidiaries) are not put in resolution, but withhold their losses to the entity to be resolved. Under the MPE strategy, more than one entity may be resolved in a banking group. Amendments to Article 2 would introduce the concepts of 'resolution entity' and 'resolution group' to clearly identify entities to be resolved under SPE and MPE strategy respectively.

According to new Articles 45f and 45g, the MREL would apply to institutions that qualify as resolution entities, requiring them to issue eligible liabilities to external third-party creditors that would be bailed-in in case the resolution entity is placed in resolution ('external' MREL). For subsidiaries that are not resolution entities an 'internal' MREL, to be met by issuing intra-group eligible liabilities, would be introduced, in line with a similar concept outlined in the TLAC standard. Subject to certain conditions, the internal MREL could be replaced with collateralised guarantees between the resolution entity and non-resolution entities of the group. In compliance with the TLAC term sheet, external Pillar 1 MREL would apply to resolution entities that are part of EU G-SIIs.

Article 45h lays down a procedure to settle on the MREL for a resolution group. It specifies the RAs that would be responsible for setting the level of the requirement for cross border groups. Any disputes between authorities would be subject to the powers of the EBA under the EBA Regulation.

Third-country provisions

The proposal also addresses the need for proportionality of bail-in related rules by revising Article 55 of the BRRD, under which banks have to include, in contracts that are governed by the law of a third country, a clause by which the creditor recognises the bail-in power of the EU resolution authorities.

Moratorium tools

Amendments to Articles 27 and 63, and the new Article 29a would establish a new moratorium tool allowing for the suspension of certain bank contractual obligations towards third parties for a short period of time in resolution as well as in the early intervention phase.

Creditor hierarchy

In a separate legislative proposal, the Commission meant to amend Article 108 of the BRRD, to partially harmonise the creditor hierarchy in case of bank insolvency, as regards the priority ranking of holders of bank senior unsecured debt eligible to meet the new MREL. The separate proposal creates a new asset class of 'non-preferred' senior debt that should only be bailed-in in resolution after other capital instruments, but before other senior liabilities.

Amendments to Single Resolution Mechanism Regulation (SRMR)

To ensure consistent implementation of the new rules on MREL within the banking union, the Commission proposed targeted amendments to the SRMR affecting the Single Resolution Board (SRB) and national RAs of the Member States participating in the SRM when they set and implement the new requirements for financial institutions established in the banking union. The proposal mirrors the proposed changes to the BRRD, specifying how they should be implemented in the framework of the SRM. Inter alia, it aligns the measurement metrics of the MREL for institutions falling under the SRM remit with those provided in the TLAC standard (Article 12a); specifies eligibility criteria for and exemptions from instruments that could count for meeting the MREL; requires the SRB to identify the level of application of the MREL (Articles 3, 8 and 9; Articles 12g and 12h); and gives the SRB 'guidance' powers to require institutions to meet higher levels of MREL (Article 12f).

Advisory committees

The European Economic and Social Committee (EESC) adopted its opinion on the banking reform package on 30 March 2017 (rapporteur: Daniel Mareels, Employers – Group I, Belgium). The EESC welcomes the package, its holistic approach and the 'risk-reducing nature of these proposals' and is 'pleased to note that the "too big to fail" issue is being addressed through the introduction of TLAC for European G-SIIs within the framework of MREL and that efforts are being made to make the bail-in rules more effective and efficient' (Point 1.5). The advisory body notes in addition that 'in order to facilitate the implementation of the resolution mechanism, further work should be done on exploring how the high level of bank sovereign debt holdings can be reduced' (Point 3.3.2).

National parliaments

The two legislative proposals have been transmitted to the national parliaments. The deadline to submit a reasoned opinion on the grounds of subsidiarity was 21 March 2017 for both files (BRRD and SRMR). No reasoned opinion was submitted. The Portuguese Parliament and the Romanian Senate engaged in 'political dialogue' with the Commission.

European Central Bank

On 8 November 2017, the European Central Bank (ECB) published an opinion on revisions to the EU bank crisis management framework, in which it welcomed the proposed amendments aiming to implement the FSB TLAC standard for G-SIIs. However, it warned that extending the scope of such amendments to other institutions would raise calibration issues; a possible extension should only cover other systemically important institutions (O-SIIs) similar to G-SIIs. The opinion addressed several issues of importance to the ECB, focusing on coordination between the proposed amendments and the prudential framework, including relevant authorities' powers.

Stakeholders' views[3]

The European Banking Federation (EBF) stressed that 'banks should be able to continue to play their role as lenders while remaining resilient'. In this regard, it called on 'the EU co-legislators to carefully review this package' and also urged them 'to be more ambitious when it comes to creating jobs and growth in Europe through an efficiently regulated single market for finance'. At a Parliament expert hearing on 25 April 2017, EBF President Frédéric Oudéa argued in favour of 'international consistency and a level playing field', and supported the Commission decision to address the topic of creditor hierarchy in a separate file. He warned however, 'that we should avoid scenarios where Europe front-loads proposals that are still in the making, as has been our experience with bank resolution, where you are being asked to revisit BRRD in light of the final international TLAC standard'.

The Association for Financial Markets in Europe (AFME) supported 'the implementation of these requirements in the EU in a manner that will enable the sector to support economic growth'. With regard to the proposed changes to the EU's resolution framework, the industry body advocates ensuring 'an effective MREL framework', to 'establish a deep and liquid market in MREL' as well as to ensure 'a level playing field across the EU and internationally'.

Finance Watch, a not-for-profit association of 48 civil society organisations, voiced reservations regarding the Commission package, its 'accompanying *sotto voce*' and its 'lack of ambition'. According to Finance Watch, the regulator's proposals display an 'over-riding concern about maintaining or improving the competitiveness of EU banks vis-à-vis overseas rivals'. With regard to resolution, the association warned in March 2016 against a 'false illusion of safety' and found MREL standards were unsuitable for providing 'a solid basis for uniform application of BRRD'. At the same hearing (see above) Christian Stiefmüller of Finance Watch stressed that not only TLAC should be 'implemented fully and without deviations from the FSB Term Sheet' but that the new binding minimum requirement ('Pillar 1 MREL') should also be introduced for O-SIIs.

Karel Lannoo from the CEPS think-tank, finds the EU's banking reform package overly complex and 'extremely difficult for lawmakers to assess these technical changes, above all with regard to the BRRD and the MREL'. He also points to blurred divisions between supervisory and resolution authorities: 'Both can require additional "capital" levels, both can withdraw a bank licence, and both will have to resolve a bank in trouble'.

Legislative process

In the Commission work programme for 2018, both BRRD and SRMR amending proposals were considered priority pending initiatives aimed at deepening economic and monetary union. They were also included in the joint declaration on the EU's legislative priorities for 2018 to 2019.

Council

Within the Council, the proposals amending the BRRD and the SRMR were examined together with the proposals amending the prudential framework, which remain part of the 'banking reform package'. An overall agreement on the package was reached by the ECOFIN Council on 25 May 2018.

Among the most debated issues were the scope of the **Pillar 1 MREL** and the calibration of **minimum mandatory subordination**, i.e. the extent to which the requirement must be met through eligible liabilities that would be bailed-in before other debt classes in case of resolution. As for the scope, the Ministers established that a Pillar 1 MREL should apply not only to G-SIIs but also to 'top-tier banks', that are institutions whose consolidated balance sheet (at resolution group level) is higher than €100 billion. In addition, RAs would be able to impose a treatment similar to top-tier banks on other institutions posing a systemic risk, based on certain conditions. The Pillar 1 MREL minimum subordination would be calibrated on the basis of TREA, LREM or TLOF. The Council would grant RAs the discretion to require additional Pillar 2 subordination for all banks up to maximum 8 % TLOF or a formula based on the risk profile of the institutions. For G-SIIs and top tier banks, this discretion is broad, while for all other banks, it would be subject to assessment of the potential breach of the NCWO principle.

The Council changed the Commission's proposal significantly as regards **MREL breaches**: it removed the MREL guidance and included the market confidence buffer (MCB) within the overall MREL requirement, while increasing the flexibility for RAs on setting its level. To compensate for these stricter requirements, framed flexibility was afforded to RAs in terms of imposing restrictions on profit distribution (MDA) when MREL levels are breached. After six months, in any case, the RA in principle shall apply restrictions unless serious general market disturbances occur or serious spill-over effects are to be expected.

The Council proposed many amendments aimed at restoring a balance between **home and host** Member States in provisions concerning cross-border groups and to operationalise the proposed Single Point of Entry (SPE) strategy in a consistent manner.

The Council compromise envisages the separation of the pre-resolution **moratorium** from early intervention measures, and would set the failing or likely to fail bank as the only absolute pre-condition to activate intervention.

Taking the possible shortfalls for MREL eligible instruments in the market into account, the Council granted a **transitional period** until 2024 for compliance with the overall requirement; for Pillar 1 MREL this deadline was brought forward to 2022.

European Parliament

Within the Parliament, the two legislative proposals amending the BRRD and the SRMR were negotiated in parallel. Parliament's Committee on Economic and Monetary Affairs (ECON) appointed Gunnar Hökmark (EPP, Sweden) as rapporteur for both texts (as well as for the proposal on creditor hierarchy). The ECON committee adopted its reports on the BRRD and SRMR amending proposals on 19 June 2018.

In the application and calculation of the MREL, Parliament proposed to take account of the fact that institutions have a high level of own capital. The Parliament's reports specify that RAs shall ensure that the level of requirement is proportionate to the specificities of the business and funding models of the resolution entity. According to Parliament, the **Pillar 1 MREL and mandatory subordination** should reflect the TLAC standard (which lays down conditions where non-subordinated debt may be used to meet the requirement) and only apply to G-SIIs. RAs would have the discretion to require **Pillar 2 MREL subordination** for GSIIs and other banks, as long as a possible bail-in of such liabilities would not result in a breach of the NCWO principle and its level does not exceed the Pillar 1 MREL.

Similar to Council, Parliament removed the MREL guidance and included the MCB in Pillar 2 MREL. As for **MREL breaches** and possible subsequent restrictions to MDA, Parliament has largely followed the Commission's approach, even though it inserted a rule stipulating a different 12 month grace period for breaches of combined buffers due to MREL shortfalls.

In its report, Parliament stipulated numerous cumulative preconditions to be fulfilled to benefit from a **moratorium** on payments during resolution.

Political agreement

The Euro Summit on 29 June 2018 raised expectations that Council and Parliament would conclude banking reform before the end of the year. Interinstitutional discussions (trilogues) on the proposals amending the BRRD and SRMR began in July 2018 and went on until early December 2018, when the co-legislators reached a provisional agreement on the entire 'banking reform package'. The agreement was endorsed by the ECOFIN Council in its meeting on 4 December 2018. Technical work followed to fine-tune the compromises reached. On 15 February 2019, Council endorsed the final agreement on the banking reform package reached between the Romanian Presidency of the Council and the Parliament. The ECON committee approved the package on 26 February 2019.

To achieve a credible bail-in tool, the co-legislators went beyond the TLAC standard by imposing a **Pillar 1 MREL and subsequent subordination** requirements not only on G-SIIs but also on 'top-tier banks', a new category of large institutions with a balance sheet size greater than €100 billion. A mandatory minimum Pillar 1 subordinated MREL was set out consisting of a total risk exposure amount (TREA) element (18 % for G-SIIs and 13.5 % for top-tier banks) and a leverage exposure measure (LREM) element (6.75 % for G-SIIs and 5 % for top-tier banks). Co-legislators also agreed on enlarging the calculation basis for the Pillar 1 MREL by including the 8 % TLOF in addition to the TLAC elements (TREA and LREM). Moreover, for a sub-set of G-SIIs and top-tier banks and under certain conditions, RAs may impose an additional **Pillar 2 subordination** requirement. For the remainder of the banks, the subordination requirement remains based on a bank-specific assessment subject to the NCWO principle.

The framework for the consequences of **MREL breaches** was re-designed following the removal by both co-legislators of the concept of MREL guidance and the inclusion of the market confidence buffer (MCB) in the MREL requirement. The agreement reached by the co-legislators on restrictions on profit distribution to shareholders or employees in case of MREL breaches builds on a framed flexibility allowing RAs to define maximum distributable amounts (MDA). For the first nine months following a breach of combined buffer requirement due to an MREL shortfall, restrictions might be applied only if certain conditions related to the nature of the breach are met. After nine months, the presumption is that restrictions must be applied, but can be waived if strict conditions (related to market conditions and broader financial stability), are met.

As for the powers of the home supervisor of a banking group and the supervisors of Member States where subsidiaries of the group are located (**home-host balance**) the co-legislators agreed on ensuring that subsidiaries in host countries meet their own MREL. A 'safe harbour' clause was therefore introduced, which enables host authorities to require: a higher internal MREL, part of which would not be subject to EBA mediation in case of divergent views between home and host authorities; collateralised guarantees in cross border situations and cross-border waivers were deleted; the 'rule of the sum' between internal and external MREL requirements in a given group was also deleted; a bottom-up approach in setting internal/external MREL targets was adopted; and intra-group liabilities were excluded from the bail-in of the parent undertaking.

The co-legislators agreed to retain a single **moratorium** power (as opposed to two different tools for supervisors and resolution authorities, as initially proposed by the Commission), which should be activated after the bank is declared 'failing or likely to fail' and other conditions are met. The power to impose a moratorium also includes covered deposits and could be imposed for a maximum duration of two days.

Parliament voted to adopt the proposals amending the BRRD and the SRMR during its 2019 April II plenary session. Council adopted them on 14 May. The final acts were signed on 20 May 2019 and published on the Official Journal on 7 June 2019. The revised SRMR applies from 28 December 2020, while Member States have to transpose the revised BRRD into national law, and apply its measures by the same date.

EP SUPPORTING ANALYSIS

Delivorias, A., Ranking of unsecured debt instruments in insolvency hierarchy, EPRS, Legislative Briefing, 2017.

Stamegna, C., Amending capital requirements. The CRD-V package, EPRS, Briefing, April 2019.

Hearing with Mrs Elke König, Chair of the Single Resolution Board, Economic Governance Support Unit, Directorate-General for Internal Policies, European Parliament, 17 March 2017.

OTHER SOURCES

Bank recovery and resolution: loss-absorbing and recapitalisation capacity of credit institutions and investment firms, European Parliament, Legislative Observatory (OEIL).

Single Resolution Mechanism: loss-absorbing and recapitalisation capacity for credit institutions and investment firms, European Parliament, Legislative Observatory (OEIL).

ENDNOTES

[1] See C. Stamegna, Amending capital requirements – The 'CRD V package', EPRS, European Parliament, April 2019

[2] See A. Delivorias, Ranking of unsecured debt instruments in insolvency hierarchy, EPRS, European Parliament, 2017.

[3] This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.

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eprs@ep.europa.eu (contact)

www.eprs.ep.parl.union.eu (intranet)

www.europarl.europa.eu/thinktank (internet)

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