Workshop
Resolution Regimes in Europe

Session II - 1° part

TLAC and MREL in relation to resolution strategy (SPE-MPE)

Vincenzo Testa
Resolution and Crisis Management Unit
Banca d’Italia

Wien, 19 April 2017
Resolution Strategies for managing the crisis a banking group

Single point of entry

- Resolution tools are applied to the top parent/holding company by a Single Resolution Authority (one single “point of entry”)

- Subsidiaries are not put in resolution. Their viability is restored by upstreaming their losses to the parent company and by receiving capital downstreamed by the parent company

- Parent company issues external LAC (loss absorption capacity) to an extent sufficient to cover losses and to recapitalize both itself and its material subsidiaries

- Material Subsidiaries issue internal LAC bought by the parent company

- In case of resolution, bail-in is applied only to the parent level; no bail-in in the subsidiaries, but mandatory write down or conversion of internal LAC
Resolution Strategies for managing the crisis a banking group

Multiple point of entry

- Resolution tools are applied to two or more entities in the banking group by two or more Resolution Authorities (two or more “points of entry”)
- Each entity planned to be resolved (point of entry) issues external LAC to an extent sufficient to absorb its losses and to recapitalize itself.

Hybrid solutions (mix of SPE and MPE)

- MPE, with an SPE for each regional block; other possible combinations.
Resolution Strategies for managing the crisis a banking group

Single Point of Entry (SPE)

Parent company

Assets

Liabilities

LAC: Loss Absorption Capacity

= equity + eligible liabilities

Resolution Entity

Subsidiary A

Assets

Liabilities

Internal LAC

Subsidiary B

Assets

Liabilities

Internal LAC

Subsidiary C

Assets

Liabilities

Internal LAC
Resolution Strategies for managing the crisis of a banking group

Multiple Point of Entry (MPE)

Parent company

Assets
Liabilities

External LAC

Resolution Entity

Resolution Entity

Resolution Entity

Resolution Entity

Subsidiary A

Assets
Liabilities

External LAC

Subsidiary B

Assets
Liabilities

External LAC

Subsidiary C

Assets
Liabilities

External LAC

LAC: Loss Absorption Capacity

\[\text{equity} + \text{eligible liabilities}\]
Resolution Strategies for managing the crisis a banking group

Hibrid SPE-MPE

LAC: Loss Absorption Capacity = equity + eligible liabilities

Resolution Entity 1

Parent company

Assets

Liabilities

External LAC

Resolution Entity 2

Subsidiary C

Assets

Liabilities

External LAC

Subsidiary C 1

Int. LAC

Subsidiary C 2

Int. LAC

Subsidiary A

Internal LAC

Subsidiary B

Internal LAC

Subsidiary C

Internal LAC
Resolution Strategies for managing the crisis a banking group

Main factors to be considered in choosing the resolution strategy

• Financial structure of the banking group

• Organizational structure of the banking group:
  A) centralization/decentralization of governance and of main internal functions (liquidity, trading, hedging, risk management, etc)
  B) Separability (financial, legal, operational/ICT)

A key factor for a successful implementation of a resolution strategy for a cross border banking group

Cooperation/Coordination (both in resolution planning and in crisis management) among different Resolution Authorities responsible for the banking group entities (home and host Authorities):
  a) Banking Groups (subsidiaries in Banking Union): SRM (SRB/NRAs)
  b) Banking Groups (subsidiaries in Europe Union): Resolution Colleges (joint decision; EBA mediation in case of disagreement)
  c) G-SIFIs (subsidiaries also outside European Union): CMGs, supported by COAGs
LAC:  a) how much  b) which kind;  c) where to be preposed (in case of groups)

FSB:  TLAC (total Loss-absorbency capacity) -> applies to G-SIBs (worldwide)

Minimum harmonized standard

a) Definition of resolution entity, resolution group and material subgroup;  b) eligible instruments (subordination);  c) distinction between external TLAC and internal TLAC;  d) TLAC expressed as a percentage of the RWAs and of leverage ratio exposure

Resolution entities (one in SPE, two or more in MPE):  minimum external TLAC (resolution entity’s equity and subordinated instruments) -> at least 16% of the RWAs (From 1th January 2019) and 18% of the RWAs from 1th January 2022;  Possible additional firm specific external TLAC requirement

Material subgroups (both in SPE and in MPE):  internal TLAC (material subgroups’ equity and subordinated instruments bought by the parent company) -> 75% - 90% of the external minimum TLAC requirement that would apply to the material subgroup if it were a resolution group.

European Parliament: BRRD- > MREL (minimum requirement for own funds and eligible liabilities) -> applies to all banks and investment firms established in European Union

Determined, case by case, by the Resolution authority (taking into account size, business model, funding model, risk profile; need to ensure - under bail-in – loss absorbency and recapitalization)

a) No definition of resolution entity, resolution group and material subgroup;  b) eligible liabilities (subordination can be required by the Resolution Authority);  c) No distinction between external MREL and internal MREL;  d) MREL expressed as a percentage of total liabilities (included own funds)
European Commission drafted a legislative package for amending CRD, CRR, BRRD, SRMR (November 2016)

One of the main objectives of the EC proposal is to transpose the TLAC framework into the European regulation and to integrate it in the existing MREL rules

To Introduce in the BRRD (for all banks, not only G-SIIs):

- the definition of resolution entity and resolution group
- the distinction between an external MREL and an internal MREL
- a harmonized regime (TLAC-MREL) for eligible financial instruments
- the use of RWAs and leverage ratio exposure for determining the MREL denominator (instead of total liabilities)
MREL structure and calibration - The European Commission proposal

**G-SIIrs**
- Harmonized minimum level as for Pillar 1 – Institution specific as for Pillar 2 and Guidance
- MREL GUIDANCE can be required by Resolution Authorities
- Combined Capital Buffer (CCB)
- MREL Pillar 2 ADD ON can be required by Resolution Authorities

**PILLAR 1**
- TLAC (16% -> 18% RWA) subordination

**OTHER BANKS (non G-SIIrs)**
- Institution specific (case by case)
- Market Confidence Buffer (CCB) AND/OR Pillar 2 B
- Combined Capital Buffer (CCB)
- MREL GUIDANCE can be required by Resolution Authorities

**MREL REQUIREMENT (HARD MREL)**
- CRD IV Combined buffer
- (subordination can be required by Resolution Authorities for NCWO reasons)

**Pillar 2 A**
- Recapitalization
- Loss absorption
- Pillar 1
Thank you for your attention

Vincenzo Testa

Director, advisor to the Head of the Resolution and Crisis Management Unit
Resolution and Crisis Management Unit
Banca d’Italia

Via Milano 64
00184 Roma, Italy
+39 06 4792 4504
+39 337 102 11 21
vincenzo.testa@bancaditalia.it