Midelatory
CONSULTING LIMITED

What is MREL?

Introduction

MREL refers to the "minimum requirement for own funds and eligible liabilities". MREL was introduced as part of the comprehensive regulatory response to the global financial crisis that began in 2007. Its goal is to ensure that banks have sufficient loss-absorbing and recapitalisation capacity to ensure a smooth and fast absorption of losses and recapitalisation in the event of resolution, with a minimum impact on taxpayers and financial stability.

Put in simple terms, MREL ensures that a bank's investors – both creditors and shareholders – would be subjected to losses in the event of its failure i.e. the authorities would be able to "bail in" investors in order to prevent (or reduce) the need for the public sector to "bail out" a failing bank.

In the UK, the Bank of England (BoE) is responsible for setting MREL. This is because, under the Banking Act 2009, the BoE is the UK Resolution Authority.

History

Following the initial global debate on the possible introduction of bail-in regimes more than a decade ago, the EU introduced MREL, in 2014, via the Bank Recovery and Resolution Directive (Directive 2014/59/EU) (BRRD). Although the debate had been mainly about mitigating the financial stability consequences of systemic bank failure, the EU's MREL was designed to apply to <u>all</u> banks irrespective of their relative potential to adversely impact financial stability.

However, the structure of that first iteration of MREL was materially flawed and, in some respects, at odds with the structure of the capital regime that it was supposed to supplement. For instance, MREL was expressed as a percentage of banks' total liabilities and own funds whereas the underlying capital regime was expressed as a percentage of risk weighted assets.

Therefore, it was a welcome development when the G20-mandated body, the Financial Stability Board (FSB), introduced its own, much better (although not flawless), version of a bail-in instrument, in 2015, in the form of Total Loss Absorbing Capacity (TLAC). Unlike the EU, the FSB directed the TLAC requirement at Global Systemically Important Banks (G-SIBs) only.

In 2019, as part of its Banking Reform package, the EU passed an updated version of its recovery and resolution law (Directive (EU) 2019/879) (BRRD2). This has greatly improved the design of MREL. The EU also took the opportunity of the Banking Reform package to implement TLAC.

Composition

MREL is designed as the sum of two components:

1. <u>Loss-Absorption Amount</u> –

- This is designed to cover the losses that would need to be absorbed up to, and in, resolution.
- In reality, this is equivalent to the Total Capital Requirement set by the PRA i.e. the sum of Pillar 1 and Pillar 2A capital requirements.

2. Recapitalisation Amount
    - This reflects the amount needed to bring a bank back into compliance with minimum requirements following a stress.
    - It also needs to be sufficient to restore market confidence in the firm post-resolution.

The criteria for MREL instruments

In order to qualify as an MREL instrument, the instrument in question must comply with the eligibility rules. Eligibility rules help to ensure that the instrument in question is not only of the right quantum but also of the right "quality".

For example, an MREL instrument must have an effective remaining maturity of more than one year. The word "effective" is to ensure that the issuing bank does not create an incentive for the issuer to redeem early before their contractual maturity date.

Importantly, an MREL instrument must be subordinated to the operating liabilities of the issuer. This ensures that it can absorb losses whilst the bank continues to honour its day-to-day liabilities.

It is also worth noting that liabilities, the value of which is dependent on derivatives, do not qualify as MREL eligible liabilities. MREL instruments must be simple, easy to understand and have straight-forward mechanisms for absorbing loss.

Quantum

MREL is expressed as a total or overall figure encompassing both the capital requirements set by the PRA and the bail-in element set by the Bank of England's Resolution Directorate.

Typically, MREL is set as two times the sum of Pillar 1 and Pillar 2A (or for firms subject to a leverage ratio requirement, two times the applicable requirement) but can be lower for certain firms.

MREL = 2x(Pillar 1 + Pillar 2A)

Conclusion

It is important to note that MREL is typically discussed as the "bail in" element of loss absorbing capacity, and in fact the eligibility criteria discussed briefly above is referring only to this element. But, strictly speaking, when the BoE sets MREL for a firm, it refers to the overall amount (i.e. PRA capital requirements plus the bail-in element) hence the "two times" approach to quantum.

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