The status of MREL in the Nordic region

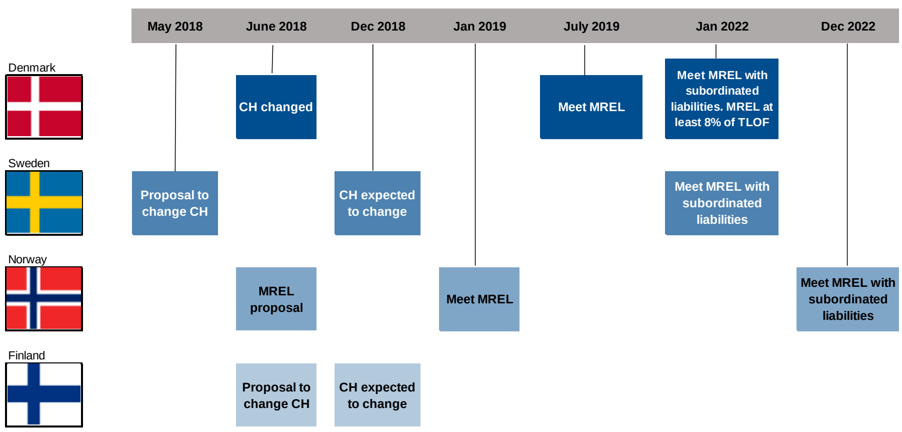
MREL developments in the Nordic countries are still in process. The approach of each Nordic country varies, and there are notable differences in how national authorities assess whether firms should be subject to MREL requirements, regardless of their systemic status. The inclusion or exclusion of capital buffers in the MREL requirement reflects differing views on the amount of bail-in resources that may be needed in a crisis scenario.

MREL – Minimum Requirement for Own Funds and Eligible Liabilities – is an important component of post-crisis reform intended to further strengthen the European banking system. In addition to resolution planning, MREL provides a means to resolve failing banks without relying on state support. For the largest EU banks, the Single Resolution Board (SRB) has set binding targets at group level although there remain ongoing discussions about calibration and how these should be met, especially for banks which are not Global Systemically Important Financial Institutions (G-SIFIs).

Each Nordic country is at a different stage of MREL implementation. In Denmark, the requirements have been set and the means for meeting them are in place. Danish banks have started issuing MREL-eligible liabilities. In Sweden, requirements have been set but national insolvency laws still need to be changed to allow for the issuance of non-preferred senior debt. In Norway, the MREL framework is being finalised while in Finland, only general guiding principles have been communicated.

As seen in European countries which have modified their bank creditor hierarchies, the larger banks have successfully issued MREL-eligible securities (non-preferred senior, holding company senior, Tier 2 and AT1 instruments). While there are numerous smaller banks in the Nordic region, with Nordea being the sole G-SIB, Scope does not foresee this as an impediment to meeting MREL requirements. Unlike some smaller banks in countries such as Italy and Spain, many Nordic banks already access wholesale markets for funding and have established investor bases. Further, banks are replacing maturing securities with MREL-eligible securities rather than just issuing new securities, which mitigates the risk of market access and investor appetite for the new securities.

Figure 1: Status of MREL implementation



Notes: CH = creditor hierarchy. TLOF = total liabilities and own funds.
Source: Regulatory authorities, Scope Ratings

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Denmark

Higher MREL requirements for SIFIs

The Danish FSA's stated resolution strategy for systemically important banks assumes that the entire institution will continue. Unlike with small and medium-sized banks, the Danish FSA does not presume that a significant part of the bank could be sold in a crisis. Consequently, MREL requirements for systemically important financial institutions (SIFIs) are significantly higher than for small and medium-sized banks and are equal to two times capital requirements (solvency requirement plus combined capital buffer requirement).

In the 1H 2018 Danish Financial Stability Report, seven credit institutions were classified as SIFIs: Danske Bank (incl. Realkredit Danmark), Nykredit Realkredit (incl. Nykredit Bank), Jyske Bank (incl. BRFkredit), Nordea Kredit, DLR Kredit, Sydbank and Spar Nord.

Mortgage banks exempt from MREL

With the implementation of the Bank Recovery and Resolution Directive (BRRD) in Denmark, authorities exercised the option to exempt mortgage banks from MREL. Under BRRD, resolution authorities can exempt mortgage credit institutions which are not allowed by national law to receive deposits and which are financed by covered bonds.

There are important implications as the seven Danish mortgage credit institutions manage assets of approximately EUR 530bn, which is greater than the approximately EUR 510bn managed by the nearly 70 banks operating in Denmark.[1] This also means that the country's second largest financial institution, Nykredit Realkredit, does not have an MREL requirement.

Instead, Danish mortgage banks are subject to a debt buffer requirement equal to 2% of their unweighted loans and which can be met with excess capital or senior resolution notes.

Nevertheless, for SIFI groups and SIFI mortgage banks, the total of the debt buffer, own funds and eligible liabilities, must equal at least 8% of total liabilities and own funds. MREL requirements can be adjusted upwards to ensure this and the 8% requirement is in effect from 1 January 2022.

When determining the level of MREL for groups, mortgage banks are not included in the consolidation. However, the risk exposure calculation considers exposures that parts of a group have toward a mortgage bank such as through ownership, guarantees and mortgage bond holdings.

The debt buffer and capital requirements of the mortgage bank cannot be met with liabilities and own funds used for MREL.

Meanwhile, Danmarks Nationalbank continues to reason that a failing SIFI group should be resolved as a single entity due to its highly integrated structure and therefore, mortgage banks of SIFI groups should be subject to MREL. Further, the central bank asserts that with MREL, the funding needs of mortgage banks would be more stable. While a mortgage bank's funding need in normal times would increase with MREL, this also means that it is better prepared for periods of falling house prices and increasing top-up collateral requirements.[2]

[1] European Banking Federation, County Facts & Figures, September 2018
[2] "MREL for mortgage banks reduces funding needs in times of crisis", Danmarks Nationalbank, 21 August 2018

For a group like Danske, the issue may be less relevant, as due to its balance sheet composition, it currently has a total requirement corresponding effectively to two times the total capital requirement of the group. Danske must meet both an MREL requirement and separate debt buffer requirement for its mortgage bank, Realkredit Danmark.

MREL must be met with subordinated liabilities

A June 2018 law created a new class of non-preferred senior debt positioned between ordinary senior claims and subordinated debt in the Danish insolvency regime for banks. The Danish FSA considers that most SIFIs have adequate capital and senior debt instruments to fulfil MREL. However, the requirement for subordination will only be met as existing senior debt matures and is replaced with non-preferred senior debt.

Consequently, MREL requirements are being phased-in:

- MREL must be met by 1 July 2019;
- Debt issued before 1 January 2018 which meets all other criteria for MREL except for subordination will qualify as MREL until 1 January 2022.

Proportionate requirements for non-SIFIs

In the case of non-SIFIs, the Danish FSA's preferred approach is to find a private solution such as a capital injection, the sale of assets, or merger with a stronger institution.

If a private solution cannot be found, the bank would be transferred to Finansiel Stabilitet, a public limited company owned by the Danish state responsible for winding-up activities taken over from distressed banks. It is expected that healthy parts of the bank would be sold while the unfit parts would be transferred to a bridge institution under the control of Finansiel Stabilitet.

For smaller banks, MREL is comprised of the solvency need and capital buffers plus a loss absorption add-on and a recapitalisation amount (the sum of the last two components is referred to as the MREL add-on). For banks with assets below EUR 3bn, the average MREL add-on is 4.7% of the risk exposure amount (REA). For banks with assets above EUR 3bn, the MREL add-on would be greater as there is a further add-on to the recapitalisation amount equal to 1.25% of the REA.

The phase-in period for smaller banks to fulfil MREL runs until end-2022. The Danish FSA considers that most banks will be able to comply with the above 4.7% add-on after five years based on projected earnings. However, this may be extended by one to two years if the Danish FSA's earnings assumptions over the period do not hold.

Sweden

In December 2017, the Swedish National Debt Office (SNDO) determined that 10 institutions have business activities which are critical for the Swedish financial system and that these institutions would be subject to resolution in a crisis. In addition to the four major banks (Nordea[3], Handelsbanken, SEB and Swedbank), these include Landshypotek, Lansforsakringar, SBAB, Skandiabanken, Sparebanken Skane and Swedish Export Credit Corporation. The remaining 152 institutions in Sweden are expected to be managed via a bankruptcy or liquidation process.

Liabilities proportion principle

The SNDO considers that MREL has two components: a part consisting of own funds instruments to cover losses and a part consisting of MREL liabilities that can be bailed-in to restore own funds. Having eligible liabilities which can only be used in resolution ensures that there is a certain quantity of resources available to recapitalise the firm in the event of resolution. Consequently, the SNDO requires firms to have MREL liabilities (debt) equal to at least the recapitalisation amount.

For the four major banks and the six institutions which are subject to resolution, the liabilities proportion principle has been in effect since January 2018 and July 2018, respectively.

Subordinated liabilities principle

By 1 January 2022, MREL should be met only with subordinated liabilities. This principle currently applies to the four major banks. Meanwhile, during 2018, the SNDO will consider whether exceptions should be made for the other six institutions subject to resolution.

In May 2018, the Swedish government proposed a bill to implement changes to the creditor hierarchy in line with the EU directive amending BRRD. The rules introducing a new layer of debt for fulfilling MREL requirements is scheduled to enter into force on 29 December 2019. In the meantime, banks have been amending their debt programme documentation to allow for the issuance of non-preferred senior debt.

Level of MREL (loss absorption amount + recapitalisation amount)

The loss absorption amount will be equal to a firm’s total capital requirements (without considering the Basel I floor), excluding the combined buffer requirement and, where applicable, macro prudential elements within the Pillar 2 requirement.

The SNDO’s rationale for excluding the combined buffer is to preserve the loss-absorbing function of the capital buffers; they can be used without breaching MREL. Owing to the liabilities proportion principle, firms in effect are not able to use all their capital for meeting MREL and in practice the combined buffer sits on top of MREL.

The recapitalisation amount will generally be equal to a firm’s total capital requirements, including the combined buffer requirement. The combined buffer is considered necessary for maintaining market confidence.

For firms which will be subject to bankruptcy or liquidation instead of resolution, the recapitalisation amount is set at zero.

Group MREL requirements for the 10 systemic institutions have been in place since 1 January 2018 and range from about 5% to 11% of total liabilities and own funds; equivalent to between 19% to 52% of RWAs.

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[3] From 1 October 2018, Nordea redomiciled to Finland and now falls under the supervision of the ECB and SRB.

Norway

The Norwegian banking sector is characterised by a few large commercial banks, some regionally-based institutions and over 100 small savings banks. In June 2018, the Norwegian FSA published a proposal for MREL which incorporates approaches seen in various jurisdictions. The consultation period ran until mid-September and the Norwegian FSA is expected to present its final proposal to the Norwegian Ministry of Finance by 1 November 2018.

Stacking order approach to placement of MREL

The loss absorption amount should consist of Pillar 1 and Pillar 2 requirements (solvency requirements) and exclude the combined buffer requirement. Instead, capital buffers should be placed on top of MREL, meaning that a breach of capital buffers would not automatically trigger a breach of MREL.

The recapitalisation amount should consist of Pillar 1 and Pillar 2 requirements as well as capital buffers. For banks subject to resolution, the Norwegian FSA believes they will need to satisfy all current buffer requirements to have full access to capital markets. There is no basis for assuming that these may be different from current levels except in the case of the countercyclical buffer.

Consequently, the recapitalisation amount for the two banks which have been classified as O-SIIs (DNB, Kommunalbanken) would comprise the following capital buffers: 2.5% conservation buffer, 3% systemic risk buffer and 2% O-SII buffer; in total 7.5%.

MREL should also be calculated on an unweighted basis (leverage basis). If this results in a higher requirement, this should be the applicable MREL.

Mortgage banks of groups may be relevant

The Norwegian FSA considers that exempting mortgage banks from MREL may incentivise their owners to transfer more assets to their mortgage banks, thus reducing the basis for the MREL calculation. Therefore, the Norwegian FSA would like the ability to adjust MREL to offset this and as well to incorporate exposures groups may have to their mortgage banks.

Subordination required

MREL should be met by 1 January 2019 and with subordinated liabilities (debt as well as excess capital) by 31 December 2022.

Non-systemic banks may also be subject to a recapitalisation amount

While acknowledging the concept of proportionality, the Norwegian FSA notes that firms which are not considered systemic, but which are important to a region or a customer group, should also be subject to resolution. In these cases, certain parts of the business may be resolved while others may be discontinued. The Norwegian FSA further asserts that the distress of small or medium-sized firms may have negative contagion effects and reduce market confidence.

Consequently, MREL requirements for the largest firms are expected to be comprised of a loss absorption amount and a recapitalisation amount. In addition, the Norwegian FSA considers that there is a basis for most Norwegian banks to be subject to a MREL requirement greater than the loss absorption amount.

Finland

In February 2018, the RVV, Finland's resolution authority, published a memorandum describing the procedure for setting MREL. In general, the approach is in line with the EC's Delegated MREL Regulation.

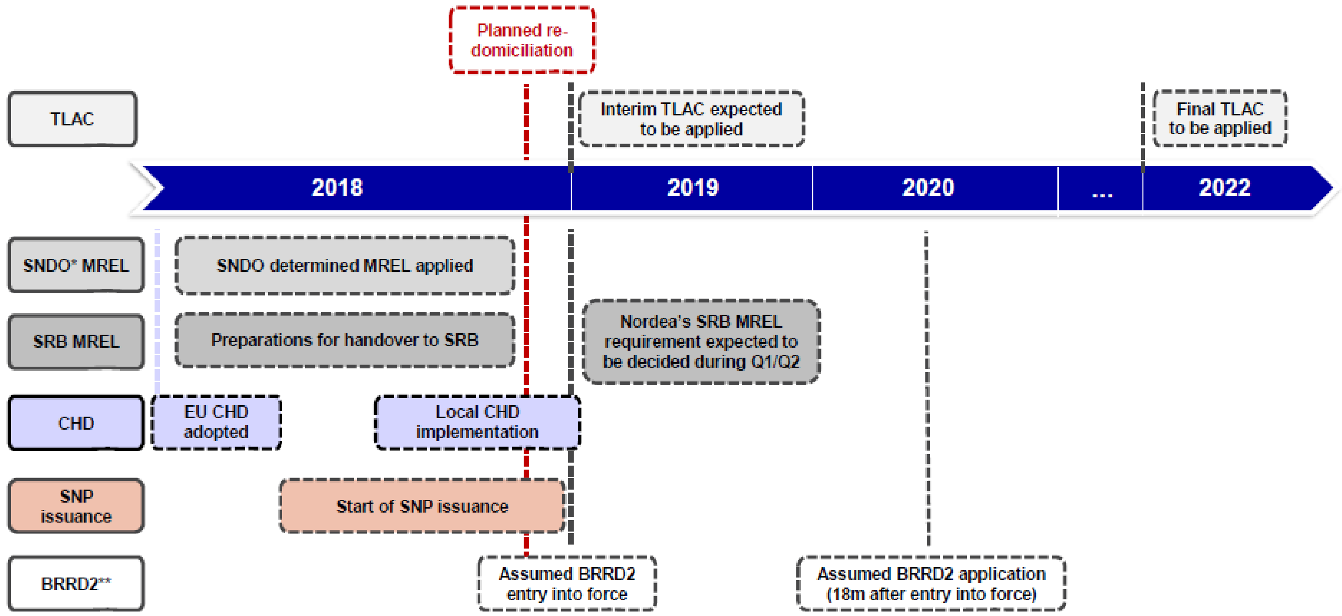
The RVV does not intend to define in advance or disclose publicly which institutions will be subject to either resolution or insolvency proceedings. This assessment is made in the context of crisis resolution planning. Further, the RVV will not publish any institution-specific MREL it has set. While institutions are not required to disclose their MREL, some have started to do so. As a rule, the RVV requires that MREL for institutions subject to resolution is at least 8% of the balance sheet total. There may be a transitional period for meeting MREL requirements.

There are no details about subordination requirements, although a June 2018 proposal to change the bank creditor hierarchy to allow for the issuance of non-preferred senior debt is under review and is expected to be passed by 29 December 2018.

As of June 2018, the Finnish FSA had classified Municipal Finance Plc, the amalgamation of OP Financial Group co-operative banks and Nordea group as O-SIIs and set O-SII buffers for them. The Finnish FSA's decision regarding Nordea was made on a conditional basis as it depended on the merger of Nordea Bank AB with Nordea Holding Oyj. With its re-domiciliation to Finland from 1 October 2018, Nordea now falls under the supervision of the ECB with its MREL requirements being determined by the SRB rather than by the RVV. Please see Appendix I for further details on Nordea's MREL situation.

Appendix I: Nordea's TLAC / MREL journey

As a G-SIB, Nordea must also meet TLAC requirements. Before its re-domiciliation to Finland, Nordea was voluntarily complying with Swedish MREL requirements.



Notes: SNDO = Swedish National Debt Office, CHD: Creditor Hierarchy Directive, BRRD2 = EU proposal for Bank Recovery & Resolution Directive.
Source: Nordea

Appendix II: Scope's Ratings on Nordic Banks

Bank	Issuer Rating	Outlook	Senior unsecured		Short-Term Rating	Short-Term Rating Outlook	Capital securities	
			MREL/ TLAC eligible	Other			AT1	Tier 2
Danske Bank A/S	A+	Negative	A	A+	S-1+	Negative	BBB-	
DNB Bank ASA	AA-	Stable		A+	S-1+	Stable	BBB-	A-
Landkreditt Bank AS	A-	Stable		BBB+				
Nordea Bank AB	AA-	Stable	A+	AA-	S-1+	Stable	BBB-	A-
Realkredit Danmark A/S	A+	Negative			S-1+	Negative		
Svenska Handelsbanken AB	AA-	Stable	A+	AA-	S-1+	Stable	BBB-	
Swedbank AB	A+	Stable	A	A+	S-1+	Stable	BB+	

Notes: Only public ratings are included. Ratings as of 2 October 2018.

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