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Application of the minimum requirement for own funds and eligible liabilities

Contents

Glossary

The technical standards	EBA's draft technical standards under Article 45(2) of the Bank Recovery and Resolution Directive: EBA FINAL Draft Regulatory Technical Standards on criteria for determining the minimum requirement for own funds and eligible liabilities under Directive 2014/59/EU, 09 February 2016.[1]
Subsidiary	a subsidiary according to point (16) of Article 4(1) of the Credit Requirements Regulation.[2]
Firm	credit institutions, investment firms, parent undertakings and other firms required by the SNDO to comply with an MREL under Chapter 4, Section 2 of the Resolution Act (2015:1016).
Own funds instruments	capital instruments that may be used to meet a firm's total capital requirements.
Eligible liabilities	debt instruments that meet the criteria in Chapter 2, Section 2 of the Resolution Act.
MREL liabilities	eligible liabilities that may be used to meet MREL (see the criteria in Chapter 2, Section 2 of the SNDO's Regulations on Resolution (RGKFS 2015:2)).
MREL	the Minimum Requirement for Own Funds and Eligible Liabilities. A requirement, expressed as a percentage, stating how large the firm's MREL liabilities and own funds must be, at least, as a proportion of the firm's total liabilities and own funds.
Parent undertaking	an EEA parent undertaking required to meet MREL on a consolidated basis under Chapter 4, Section 2 of the Resolution Act.

[1] https://www.eba.europa.eu/documents/10180/1359456/EBA-Op-2016-02+Opinion+on+RTS+on+MREL.pdf/39ae4d89-209d-4d8e-aed6-d922e4b3495b

[2] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

MPE strategy	resolution with multiple points of entry, i.e. a resolution strategy based on some or all of the firms in a group being placed into resolution and dealt with separately from one another.
MREL instruments	own funds instruments and MREL liabilities.
Resolvability assessment	the determination under Chapter 3, Sections 10 and 11 of the Resolution Act of whether a firm can be reorganised or wound up through bankruptcy, liquidation or resolution in a way that does not lead to a serious disruption in the financial system.
SPE strategy	resolution with a single point of entry. i.e. a resolution strategy based only the parent undertaking in a group being placed into resolution.

<u>Definitions relating to capital requirements</u>

Basel I floor	the capital requirement under Article 500 of the Credit Requirements Regulation.
Combined buffer requirement	the combined buffer requirement under Chapter 2 of the Capital Buffers Act (2014:966).
Minimum capital requirements	the own funds requirements under Articles 92 and 458 of the Credit Requirements Regulation.
Pillar 2 requirements	capital requirements (over and above the minimum capital requirement and combined buffer requirement) that arise as a result of the comprehensive capital assessment made by the Swedish FSA and, where applicable, a decision on a special own funds requirement under Chapter 2, Section 1 of the Act on Special Supervision of Credit Institutions and Investment Firms (2014:968).
Total capital requirement	the sum of minimum capital requirements, pillar 2 requirements and the combined buffer requirement or, if higher, the Basel 1 floor.

Summary

A new framework for crisis management of banks, investment firms and certain other firms came into force in Sweden on 1 February 2016. The new framework means the government, via the Swedish National Debt Office (SNDO) can take control of a crisis stricken firm, for example a bank, by means of process known as "resolution", if this is required to preserve financial stability. In a resolution the shareholders and lenders will be exposed to the crisis-stricken firms losses, not the government. The lenders' liabilities will, in simple terms, be written down in the same way as in bankruptcy, albeit with certain exceptions. Debt write down (also known as "bail-in") will therefore become the central tool for handling bank crises.

In order to execute a resolution, firms must have a certain amount of own funds and liabilities that can be written down in order to cover losses and reinstate the bank's capital base in a crisis. A specific requirement is therefore being introduced, the minimum requirement for own funds and eligible liabilities (MREL). This requirement has to be met at all times.

The introduction of MREL is a key part of the EU Bank Recovery and Resolution Directive[3], which underpins the Resolution Act. The SNDO, as the designated Resolution Authority, will make decisions on the specificities of MREL requirement.

The level of MREL

MREL shall comprise the sum of a *loss absorption amount* and a *recapitalisation amount*.

Loss absorption amount: shall be equivalent to a firm's total capital requirements (without taking into account the Basel I floor), excluding the combined buffer requirement and, where applicable, the Pillar 2 systemic risk component.

Recapitalisation amount: shall be equivalent to a firm's total capital requirements, including, where applicable, the Basel I floor. The recapitalisation amount shall be zero for firms that are not expected to be placed into resolution, i.e. firms which are deemed capable of being wound up through bankruptcy or liquidation.

[3] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

MREL will be set according to the above principles from autumn 2017, after the Swedish FSA's annual comprehensive capital assessment *(Swe: samlade kapitalbedömning)* is complete and, where applicable, after the consultation and decision-making process in the resolution colleges for cross-border firms has been completed. Until that time MREL for firms will be set to the same level as each firm's total capital requirement.

Complying with MREL

The SNDO will, as a specific part of the resolvability assessment process, evaluate how institutions comply with MREL. For the firms that are planned to be managed by resolution, it is expected that the following principles should be complied with in order for the firm to be deemed resolvable.

Liabilities proportion: firms should have MREL liabilities which are at least equivalent to the recapitalisation amount.

MREL liabilities within groups: MREL liabilities for groups where the preferred resolution strategy is an SPE should meet certain specific criteria. Liabilities that are used to meet MREL requirements on a consolidated basis should be issued by the parent undertaking and be held by third party entities outside the group. Liabilities that are used to meet MREL of subsidiaries on an individual basis should consist solely of liabilities to the parent undertaking. In addition, these liabilities should be subordinated to the subsidiary's other liabilities and should be capable of being written down or converted without the subsidiary needing to be placed into resolution.

The SNDO will assess firms' resolvability on the basis of these principles from autumn 2017. For firms that do not comply at that time with these principles, the SNDO will, unless otherwise shown, conclude that an impediment to resolvability applies and accordingly initiate a process to address the impediments.

Subordination and cross-holdings

Two further principles which the SNDO considers should be complied with in order for institutions to be deemed resolvable are that:

- MREL liabilities should be subordinated to other liabilities, and
- risks related to holdings of other institutions' eligible liabilities and/or MREL compatible liabilities ("cross-holding") should be limited.

However at this stage, the SNDO does not intend to introduce requirements related to these principles or apply them as part of the resolvability assessment. The reason for this is that SNDO considers that further impact assessment analysis is required and additionally wishes to take account of ongoing international regulatory activity before a final decision on these matters is made. Regarding a subordination requirement, the SNDO's view is that such a requirement should be introduced in the future. The SNDO is planning to publish further information at the start of 2017 regarding *the nature, extent and implementation timetable* for such a requirement.

1. Introduction and purpose

In May 2014 the Council of the European Union and the European Parliament adopted the Bank Recovery and Resolution Directive. This Directive establishes harmonised rules in the EU for managing crises in credit institutions, investment firms and certain group firms (collectively called firms below). The Directive creates a special process for the reorganisation and winding-up of such firms that is called resolution. The rules for resolution differ from the rules for reorganisation and winding-up that apply to companies in general. The purpose of the rules is to make it possible to manage crisis-stricken financial firms, especially those of considerable importance for the financial system, without causing contagion that threatens financial stability and without central government being forced to intervene and provide financial support. Many EU countries have not had such rules, and this also applies to some extent to Sweden.

The Directive has mainly been implemented in Swedish law through the Resolution Act (2015:1016), the Resolution Ordinance (2015:1034) and the SNDO's Regulations on Resolution (RKGFS 2015:2).

1.1 Bail-in under resolution

A resolution process means that, if it is considered necessary to preserve financial stability, central government takes control of a failing firm through the resolution authority and keeps all or parts of its operations going. At the same any losses and recapitalisation needs have to be covered by the owners and creditors of the failing firm. In functional terms, this can mainly be done in two ways: either by applying the bail-in tool or by the resolution authority first selling or transferring the bank's critical operations to a new owner and then leaving the remainder of its operations to be wound up through bankruptcy.

Irrespective of which of these two courses is applied, it is only possible to implement resolution effectively if the firm has sufficient capital and liabilities that can be used to meet losses or, in the case of liabilities, be converted into share capital.

In resolution capital always bears losses. But this does not apply to liabilities. This is because under the regulatory framework for resolution certain classes of debt *shall* be excluded from any write down and conversion and the resolution authority *may* in extraordinary circumstances exclude liabilities that would otherwise have been eligible for write down or conversion.

1.1.1 The need for MREL

Since certain debts must or may be excluded from a bail-in, firms could finance themselves in such a way that means that their capital and bail-inable liabilities are not sufficient to enable resolution to be executed. In addition, the exclusion rules also mean that departures are made in certain cases from the order of priority that applies to liabilities in a normal bankruptcy. As a result, situations may arise in which creditors that are not excluded from a write down are left worse off in resolution than if the firm had instead been wound up through bankruptcy or liquidation, which is contrary to the general rules for creditor protection in the regulatory framework for resolution.

To avoid these problems arising, rules are required about the minimum amount of capital and bail-inable liabilities firms must have to be able to execute resolution and about what characteristics the capital and debt instruments used to meet the requirement must have.

1.1.2 Level of MREL

The Resolution Act therefore provides that every firm has to meet a special minimum requirement for bail-inable liabilities, known as MREL. The *level* of MREL is not stated in the Act and has instead to be set by the SNDO. This is to be done on the basis of a number of criteria set out in the SNDO's Regulations concerning resolution. These criteria will be specified in more detail in the technical standards regarding the MREL. These standards have still to be adopted.

1.1.3 Complying with MREL

As regards *compliance* with MREL, the SNDO's Regulations contain certain explicit rules about the characteristics that debts must have to be eligible, for example that debts must have a minimum remaining maturity of one year. In addition to this, the resolution authority also has some powers to ensure that a firm can if required, be managed through resolution without serious systemic implications and without the use of public funds (resolvability assessment). The resolution authority can use these powers to order a firm to take certain measures if the authority makes the assessment that there are material impediments to reorganising or winding up the firm through bankruptcy, liquidation or resolution and the firm itself does not propose measures that can remove or reduce these impediments in an effective way.

1.2 Purpose

The purpose of MREL is to ensure that firms that may be placed into resolution have sufficient capital and liabilities to be able to cover losses and restore their capital base. The purpose of this memorandum is to set out how the SNDO intends to set MREL. The memorandum deals with the level of MREL and with the SNDO's view on certain questions linked to MREL that are of importance for firms to be deemed to be resolvable.

1.3 Timetable for setting MREL

The SNDO's intention is to make the first decisions on MREL at the end of 2016. MREL will then correspond to firms' total capital requirements. As of the last quarter of 2017 MREL will be set in accordance with the model outlined in this memorandum, which means – for those firms that are assessed as needing to be managed through resolution in the event of failure – a requirement that exceeds the firm's capital requirement. Thereafter decisions on MREL will be reviewed at least once a year or in the event of material changes in the operations of individual companies.

Since the Swedish FSA's comprehensive capital assessment is an important input to the setting of MREL, the SNDO intends to set MREL shortly after the Swedish FSA announces the outcome of its capital assessment, which it does at the end of September.

For firms that are part of cross-border groups, any decision on MREL has to be taken jointly with other relevant resolution authorities working within 'resolution colleges'.

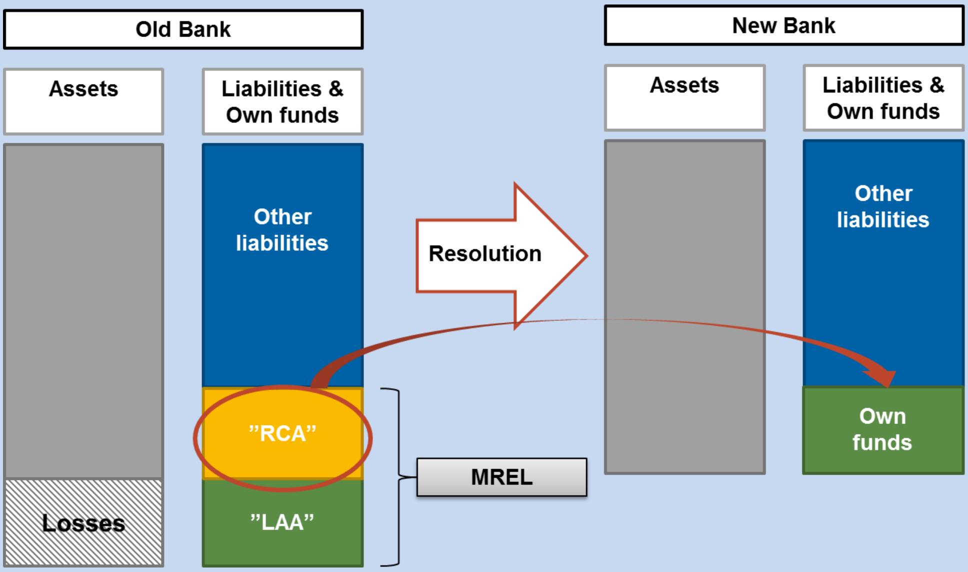
Box 1 Illustration of the purpose and function of MREL

Requiring firms to have sufficient capital (capital requirements) to be able to bear unexpected losses that may be incurred during economic stress is nothing new. However MREL means the introduction of a new and complimentary requirement that firms must, in addition to their loss-bearing capital, also have sufficient capital or debt instruments to be able, when required, to be *recapitalised*, if the losses in the firms are so large that the firms are failing or at risk of failing.

Recapitalisation means that it has to be possible to restore the own funds of a firm under resolution to a level that is line with the firm's capital requirements. This restoration occurs by bailing in some of the firm's liabilities or converting them into shares, a process known as a *bail-in*.

MREL for an individual firm consists of two components: a loss absorption amount (LAA), corresponding in broad terms to the firm's capital requirement and a recapitalisation amount (RCA), corresponding to the amount required to restore its capital to the requirement levels that will apply to the firm after resolution.

The figure below provides an outline illustration of a bail-in and conversion for a firm where *all* its operations are preserved and continue to operate.



In this example the "Old Bank" incurs losses corresponding to the whole of its LAA, which means that all its own funds have been consumed and the bank fails. Since the bank is of material importance for the financial system, it is placed into resolution by the SNDO, which executes a bail-in and conversion in order to restore its own funds in accordance with the resolution plan adopted for the bank. The amount converted corresponds to the RCA, which makes up, after conversion, the capital base of the "New Bank".

By setting the MREL, the SNDO thus ensures that there is sufficient loss absorption and recapitalisation capacity in systemically important banks to be able to manage them through resolution and thereby maintain their socially important functions.

1.4 The FSB's TLAC standard

In parallel to the development of the EU regulations concerning MREL, the Financial Stability Board (FSB), a G20 body, has published an international standard that requires globally systemically important banks to maintain a certain minimum loss-absorption capacity, (*Total Loss-Absorbing Capacity, TLAC*). Even though the standard is not identical to the EU rules, both frameworks build on the same conceptual foundation, i.e. that banks and certain other financial firms must have sufficient capital and bail-inable liabilities to enable resolution to be executed without serious systemic consequences and at no cost to the taxpayer.

Since the TLAC requirements only apply to globally systemically important banks, the scope of the provisions of the standard is much narrower than that of the EU rules. Among Swedish firms, only Nordea Bank AB has been assigned the status of a globally systemically important bank.

The TLAC standard is non-binding but the EU Commission has announced that in 2016 it intends to draft a proposal for the implementation of TLAC in EU law.

In the policy positions presented in this memorandum the SNDO has taken some account of the provisions of the standard, drawing on aspects that, in the view of the SNDO, contribute to a better design of MREL for all firms, i.e. not just globally systemically important banks, and that are compatible with the provisions of the regulatory framework for resolution. However, the SNDO does not currently intend to apply the standard fully and is instead choosing to await the implementation process initiated by the Commission.

2 Level of MREL – legal basis

2.1 Swedish law

Chapter 4 of the Resolution Act and the SNDO's Regulations on Resolution contain provisions concerning MREL. Under Chapter 4, Section 3 of the Resolution Act, the Resolution Authority shall set MREL taking into account the circumstances in each individual case, in order to ensure that a company, if placed into resolution, has eligible liabilities and own funds that together are sufficient to make it possible to take resolution actions that meet the resolution objectives.

The specific criteria that shall form the basis for a decision on the level of MREL are set out in the SNDO's Regulations on Resolution.[4] The technical standards (see below) specify in more detail how to apply the criteria in the regulations.

- The Level of MREL Firms must meet MREL at all times. MREL shall be expressed as a proportion of the firm's own funds and total liabilities. The Resolution Act does not specify any explicit level for the requirement and this is to be decided by the Resolution Authority for each firm individually, after consulting the supervisory authority. The decision has to be based on a number of criteria given in SNDO's Regulations that are specified further in the technical standards (see below).
- Application of the requirement MREL must be met by all firms on an individual basis. In addition, parent undertakings must meet the requirement on a consolidated basis. For cross-border groups the consolidated requirement is set by the parent undertaking resolution authority in consultation with the resolution authorities in the host countries of the subsidiaries according to a process laid down in law.

2.2 The technical standards

2.2.1 Introduction

In practical terms, the technical standards outline a set method for deciding the level of MREL. The Resolution Authority has some scope to make its own assessments and choices, but may only do so within set limits.

[4] Chapter 2, Sections 4-7 of the SNDO's Regulations on Resolution (RKGFS 2015:2). These provisions implement the parts of Article 45(6) of the Bank Recovery and Resolution Directive that were not introduced through Chapter 4, Section 3 of the Resolution Act.

According to the technical standards MREL should comprise of the sum of two components: a loss absorption amount and a recapitalisation amount. Both amounts have to be set on the basis of the firms' capital requirements and the resolution authority's own assessment of the firm's risk characteristics (size, business model and financing profile).

In addition, a number of other factors have to be taken into account in setting MREL, and this may necessitate adjustments to the level calculated above. According to the technical standards these factors are:

- the scope of any exclusions from bail-in and conversion
- the size and systemic importance of the firm
- contributions from the deposit guarantee scheme to the financing of resolution

2.2.2 Loss absorption amount

The starting point for the loss absorption amount according to the technical standards is that it has to be equal to the firm's total capital requirement, i.e. it has to be the sum of the firm's minimum capital requirement, pillar 2 requirement and combined buffer requirement or any higher amount that is required to meet the Basel 1 floor or applicable gross leverage requirements (default loss absorption amount[5]). However, in certain circumstances the resolution authority may decide that the loss absorption amount shall be different from the default amount.

A *higher* loss absorption amount may be set if

1. the resolution authority considers, taking account of information from the supervisory authority about the firm's business model, funding model and risk profile[6], that the components included in the default amount do not fully reflect the need for loss absorption in resolution, or
2. that it is necessary in order to reduce or eliminate an impediment to resolution or to absorb losses on holdings of instruments issued by other entities in the group that may be included in the minimum requirement.

A *lower* loss absorption amount may be set if the resolution authority considers, taking account of the information from the supervisory authority's information about the firm's business model, funding model and risk profile, that

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[5] Called “default loss absorption amount” in Article 1 of the technical standards.
[6] Article 4 of the technical standards specifies which supervisory information is meant

- pillar 2 requirements based on outcomes of stress tests or intended to cover macroprudential risks are deemed not to be relevant to the need to ensure that losses can be absorbed in resolution, or
- parts of the combined buffer requirement are not relevant to the need to ensure that losses can be absorbed in resolution.

2.2.3 Recapitalisation amount

The starting point for the recapitalisation amount according to the technical standards is that it has to be set on the basis of what is required in order to be able to execute the preferred resolution strategy in the resolution plan. The recapitalisation amount may be set at zero if the resolvability assessment shows that it is feasible and credible to wind up the firm through ordinary insolvency proceedings, i.e. if the firm is *not* expected to be placed into resolution. For these firms MREL will be equal to the loss absorption amount.

For firms that may be placed into resolution the recapitalisation amount has to consist of two parts:

- The amount necessary for the firm to meet, after the execution of the preferred resolution strategy, the capital requirements that apply to its authorisation, including minimum capital requirements, pillar 2 requirements and the Basel 1 floor and applicable leverage requirements, but not any buffer requirements.
- The additional amount considered necessary by the resolution authority to maintain sufficient market confidence in the firm after resolution. This amount shall correspond to at least the combined buffer requirements that are applicable after the application of the resolution tools (default additional amount for recapitalisation). But the additional amount may be lower (but not less than zero) if the resolution authority considers that this is sufficient to maintain market confidence, critical functions and access to funding. The assessment of the size of the amount shall also take into account whether the capital position after resolution is appropriate in comparison with the current capital position of peer firms.

Despite what has been said above the resolution authority can disregard all or parts of the pillar 2 requirement or the buffer requirements when it sets the recapitalisation amount. The authority may do so if, after consultation with the supervisory authority, it determines that all or parts of these requirements do not need to be applied after the execution of the resolution strategy.

For a firm that is part of group, the resolution authority shall, when it sets the recapitalisation amount, also take account of capital in other parts of the group that may be available to maintain market confidence in the firm after resolution.

2.2.4 Other criteria to be taken into account in setting MREL

The resolution authority may *reduce* the minimum requirement in view of the amount that the deposit guarantee scheme may be expected to contribute under the preferred resolution strategy. That amount shall be set taking account of the limitation rules set up by the Bank Recovery and Resolution Directive for the use of the deposit guarantee scheme in resolution, and also the risk of exhausting the financial means available in the deposit guarantee scheme.

The resolution authority shall also ensure that MREL is sufficient considering the liabilities that may be excluded when the bail-in tool is applied or be transferred in full when one of the other resolution tools is applied. This shall be determined in two ways: first, on the basis that MREL liabilities that may be excluded or transferred and therefore erode the loss absorption and recapitalisation capacity of the firm and, second, considering that the exclusions or transfers, irrespective of whether or not the liabilities are MREL liabilities, may result in a breach of the Directive's safeguard that a creditor of a company that has been placed under resolution must not be left worse off than if the firm had instead been wound up through normal insolvency procedures. The latter determination need only be carried out if the liabilities that may be excluded or transferred constitute more than 10 per cent of the firm's liabilities with the same ranking in insolvency as those that may be transferred or excluded.

Finally, when setting MREL for systemically important firms the resolution authority shall also take account of the requirements provided for in Article 44 of the Bank Recovery and Resolution Directive. i.e. the requirements that regulate the option for the resolution authority to exclude liabilities from a bail-in and the circumstances under which such exclusions can be financed from the financing arrangement for resolution (in the case of Sweden, the resolution reserve).[7]

[7] These requirements say that before financial means from the resolution reserve may be used, shareholders and holders of capital instruments and eligible debts must have met losses and/or accounted for recapitalisation in an amount corresponding to 8 per cent of total liabilities and capital/own funds, or 20 per cent of the total risk-weighted exposure.

3 Level of the Minimum Requirement – the SNDO's views

The SNDO's policy position: All firms have to meet an MREL that is the sum of a *loss absorption amount* and a *recapitalisation amount*. Both amounts shall be calculated on the basis of the capital requirements that apply to the firms.

The loss absorption amount shall be equivalent to the firm's total capital requirements (without taking into account the Basel I floor), excluding the combined buffer requirement and where applicable, the Pillar 2 systemic risk add-on.

The recapitalisation amount shall be equivalent to the firm's total capital requirements, including, where applicable, the Basel I floor. The recapitalisation amount shall be set at zero for firms that are not expected to be placed into resolution, i.e. firms that are deemed capable of being wound up through bankruptcy or liquidation.

At present the SNDO does not intend to make use of the possibility to adjust MREL on any of the other grounds that follow from the technical standards.

3.1 Introduction

The technical standards set the framework for decisions by the SNDO on the level of MREL. As shown in section 2.2, the calculation model prescribed by the standards gives the resolution authority certain discretion to take its own decision on how to calculate the various MREL components and adjustment amounts. This chapter sets out how the SNDO intends to apply the provisions of the standards. The starting point regarding MREL is that it has to be high enough to ensure that planned resolution actions can be taken if the firm is placed into resolution.[8]

3.2 MREL and Pillar 2 requirements

When calculating MREL, the firm's Pillar 2 requirements shall, as a general rule, be included in both the loss absorption amount and the recapitalisation amount according to the technical standards.[9]

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[8] Chapter 4, Section 3 of the Resolution Act and Article 45(6)(a) of the Bank Recovery and Resolution Directive.
[9] Articles 1(2)(b) and 2(6)(b) of the technical standards.

However, the Swedish FSA does not normally make any formal decisions on pillar 2 requirements. Instead the Swedish FSA notifies each firm of the outcome of the comprehensive capital assessment that the Swedish FSA makes regarding the firm. Formal decisions are only made in cases where this is considered necessary.

In view of what is specified in the technical standards and the purpose of setting MREL, the SNDO's assessment is that the pillar 2 requirement which results from the Swedish FSA's comprehensive capital assessment that are relevant to loss absorption and recapitalisation shall be taken into account in MREL calculation as if it had been set in a formal decision. The sections concerning the loss absorption and recapitalisation amounts set out how, and what parts of, the pillar 2 requirement will be taken into account.

3.3 Loss absorption amount

3.3.1 Default loss absorption amount

The SNDO's policy position: The loss absorption amount shall be determined without considering the firms' Basel I floor or leverage ratio.

The loss absorption amount shall be set on the basis of the default amount for loss absorption specified in the technical standards. The default amount shall consist of the sum of the institution's minimum capital requirement of 8 per cent of risk-weighted assets, pillar 2 requirements and combined buffer requirements *or* the higher amount required to meet the Basel 1 floor or applicable leverage requirements. Thus the resolution authority is given an option to decide whether or not to take account of the Basel 1 floor or leverage requirement – if one of them is higher – when setting the default amount.

Leverage ratio requirements and the Basel 1 floor

Swedish firms are currently covered by requirements to calculate their leverage ratio and report it to the Swedish FSA. But no formal, binding leverage ratio requirement is applied at present. Against this background, in combination with the fact that the leverage ratio measure is not risk sensitive, the SNDO considers that no account should be taken of firms' leverage ratio when the default amount is set. In the event that a formal leverage ratio requirement is introduced, the SNDO will reconsider this policy position.

As regards the Basel 1 floor, this is a binding requirement that results *de facto* in a higher formal capital requirement for certain firms. Nevertheless, the SNDO considers that this requirement should also not be taken into account when setting the default amount. This is because the floor is based on calculation methods that, like the leverage ratio measure, do not provide a sophisticated estimate of the firms' actual loss risks.

For these reasons the SNDO considers that the default amount for loss absorption should solely be set on the basis of the total capital requirement calculated without reference to the Basel 1 floor or the leverage (ratio) requirements. This means that the loss absorption amount will be based on the measure that gives the most correct estimate of the unexpected losses that a firm can be expected to incur.

3.3.2 Conditions for a *higher* loss absorption amount

The SNDO's policy position: There is no reason to decide on a higher loss absorption amount than the default amount.

The resolution authority can choose to set a higher loss absorption amount than the default amount if

1. the default amount does not fully reflect the loss absorption need in resolution[10], or
2. it is necessary in order to
    - remove or reduce an impediment to resolution, or
    - absorb losses on holdings of capital instruments and eligible liabilities issued by other firms in the group.

As regards the possibility of setting a higher amount on the basis that the default amount does not fully reflect the loss absorption need, the SNDO notes that the capital requirements decided by the Swedish FSA, which form the basis for the default amount, are specifically set with the intention of being sufficient to absorb the losses of each individual firm. In addition, these capital requirements are based on sophisticated calculation methods for estimates of loss risks, which Swedish FSA also supplements with in-depth assessments and analyses. The SNDO therefore considers that it is neither necessary nor appropriate for the resolution authority to conduct its own examinations of the loss absorption need and to set a loss absorption amount that is higher than the default amount on this basis.

As regards adjustments of the loss absorption amount to remove impediments to resolvability, the SNDO has not identified any circumstances, over and above those already covered by the standards, in which this would be appropriate. The SNDO's assessment is therefore that there will be no need for upward adjustments of the default amount on account of this.

As regards holdings of capital instruments and eligible liabilities issued by other firms in a group, part of the risks associated with such holdings are handled through the rules for deductions for holdings of own funds instruments that follow from the current capital adequacy regulations (in functional terms a deduction from MREL instruments is the same thing as an upward adjustment of MREL). There are at present no equivalent rules for deductions regarding MREL liabilities or eligible liabilities, which could therefore justify an upward adjustment.

However, the need to make such adjustments is dependent on what general restrictions linked to the firms' cross-ownership of MREL liabilities and/or eligible liabilities will be applied. As indicated in section 7.5 the SNDO intends to revert to the question of such restrictions at a later date. If they are framed in a way that justifies upward adjustments of MREL, the SNDO will announce this in conjunction with a decision on what restrictions should apply. Until that time, the SNDO does not intend to apply the possibility of adjusting the loss absorption amount upwards for holdings of liabilities issued by other firms in the same group.

3.3.3 Conditions for a *lower* loss absorption amount

The SNDO's policy position: The combined buffer requirement and the systemic risk add-on in pillar 2 will be excluded when setting the loss absorption amount.

The resolution authority is able to set a lower loss absorption amount if parts of the capital requirements used in the calculation of the default amount are judged not to be relevant to securing loss absorption needs in resolution. The capital requirements that can be excluded on these grounds are, first, the pillar 2 requirements based on the outcome of stress tests or intended to cover macroprudential risks and, second, non-relevant parts of the combined buffer requirement.

Considering how the regulatory framework for capital adequacy is applied for Swedish firms, it can be noted that there are a number of components of the capital requirement that meet the criterion of not being relevant to securing loss absorption needs in resolution.

With respect to the combined buffer requirements, the view of the SNDO is that the function of the capital buffers should be capable of absorbing losses *before* resolution. The capital used to meet these buffers should be capable of being used without consideration being given to resolution actions. If the buffer requirements are included as part of the loss absorption amount, the risk is that it will, on the contrary, only be possible to use the buffers *in* resolution. So the buffer requirements should not be regarded as relevant to loss absorption in resolution and should therefore not be included as a component in the setting of the loss absorption amount either.

However, excluding the buffers in this way when calculating the loss absorption amount does not mean that the aggregate loss absorption and recapitalisation capacity of the firms is weakened. As indicated in section 7 the SNDO intends to set up certain principles regarding MREL compliance, one of which will be that a certain part of MREL should be met using MREL liabilities. One effect of this principle is that firms will not be able to count all of their capital in order to comply with MREL.

By not allowing firms to double count parts of their capital in this way, the buffer requirements are, in practice, placed on top of MREL. One consequence of this is that it will be possible for firms to use this capital without infringing on MREL. A design of this kind thus allows the capital buffers to fulfil their intended purpose, i.e. to be an actual buffer against losses without this resulting in breaches of the capital requirements that apply for the firm's authorisation.

The pillar 2 requirements include a systemic risk add-on that is only applicable to firms assessed to be of systemic importance. Along with the systemic risk buffer, this supplement amounts to an extra capital requirement of five percentage points for systemically important firms. These requirements both have the same purpose: to strengthen the resilience of the financial system to systemic risks. The choice made by the Swedish FSA to divide this extra capital requirement into a buffer requirement (three percentage points) and a pillar 2 requirement (two percentage points) is attributable to the design of the regulatory framework.[11] Against this background, the SNDO considers that these requirements should both be handled symmetrically and that the systemic risk add-on in the pillar 2 requirement should therefore be excluded when calculating the loss absorption amount.

3.4 The recapitalisation amount

3.4.1 General comments on the recapitalisation amount

The recapitalisation amount is to be set on the basis of what is required to execute the preferred resolution strategy drafted by the resolution authority for the firm concerned. In practice this is a matter of ensuring that MREL is designed in such a way that the firm can meet its expected capital requirements after resolution has been executed. According to the technical standards, to achieve this the amount must be calculated on the

[11] See the Swedish FSA's memorandum "Capital requirements for Swedish banks" ("Kapitalkrav för svenska banker")(FI Reg. no 14-6258)

basis of the capital required so that, after resolution, the firm complies with the capital requirements that apply to its authorisation and is able to retain sufficient market confidence. In the same way as for the loss absorption amount, the resolution authority can choose not to count some of the capital requirement components that should, according to the basic rule in the technical standards, otherwise form the basis for the recapitalisation amount.

Since recapitalisation will only need to take place regarding the parts of the firm that will, according to the resolution strategy, survive after the execution of the resolution strategy, the recapitalisation amount only needs to reflect the capital requirements in these parts of the firm. For this reason the recapitalisation amount can be set at zero for the category of firm that is assessed as being capable of being handled through bankruptcy or liquidation, i.e. outside resolution.

For firms that, according to their resolution plan, will solely be handled by applying the bail-in tool *(whole bank bail-in)*, the recapitalisation amount will, in contrast, need to reflect the recapitalisation need of the expected size of their operations at the time of resolution. Since it is difficult to make an advance assessment of the scale of operations at the time of resolution, this means that the recapitalisation amount must, in practice, be set on the basis of the scale of all existing operations, i.e. on the basis of the capital needs that the firm's present operations would entail after resolution.

A third category of firm consists of firms only parts of whose operations are assessed as critical. For these firms the resolution plan anticipates that it will be possible to separate out critical functions from the remainder of the firm by, for example, applying the sale of business tool or the bridge institution tool. Since it is only the operations that are sold or transferred that need to be recapitalised, the capital requirement will be lower than if it had been necessary to continue all of the firm's operations. This means that the recapitalisation amount does not necessarily need to reflect capital needs of the entire firm. For example, a firm whose resolution plan anticipates that half of its assets will be transferred to a bridge institution while the remaining half will be left to be wound up through bankruptcy could be assigned a recapitalisation amount corresponding to half of the capital requirement for all of its operations (assuming that all of the firm’s assets have the same risk-weighting).

In section 3.5 the SNDO describes how it intends to identify the firms that are not expected to be placed into resolution and whose recapitalisation amount can therefore be set at zero. For other firms the SNDO will only take a policy position on a resolution strategy and an associated recapitalisation amount when the individual resolution plans are adopted. However, the preliminary assessment made by the SNDO is that at least the firms classified in a capital adequacy context as of systemic importance (called G-SIIs and O-SIIs) will be assigned a recapitalisation amount equivalent to the scale of all of their existing operations.

3.4.2. Supporting information for calculating the recapitalisation amount

The technical standards state that the calculation of firms' capital needs after the execution of their resolution strategy shall be based on the most recent reported values for the total risk exposure amount or, if applicable, the exposure amount used for calculating their leverage ratio.

But the resolution authority is given the possibility of adjusting these exposure amounts so as to adapt the recapitalisation amount to the resolution strategy chosen. Such an adjustment may only be made after consulting the supervisory authority and providing that the resolution plan shows that the planned resolution actions lead to direct changes in the capital need and that the resolvability assessment shows that these changes are feasible and credible without adversely affecting the firm's critical functions and without the institution needing to receive extraordinary financial support.

It is through these adjustments that the recapitalisation amount is adapted to the preferred resolution strategy in technical terms. If, for example, the strategy is based on recapitalising half of the operations, the supporting information for setting the recapitalisation amount only needs to include the amount of exposure attributable to this part of the operations.

The resolution plans drawn up for individual firms will contain an assessment of what capital needs would result from execution of the resolution strategy and of whether the strategy is feasible and credible without the use of extraordinary financial support. In addition, the whole of the planning process is covered by an obligation to consult with the supervisory authority. In the context of this consultation the SNDO will obtain the views of the Swedish FSA on the resolvability assessment and the exposure amount to be used to set the recapitalisation amount. The requirements that must be met according to the technical standards in order to adjust the exposure amount will thus be met when the resolution plans are adopted. Therefore, in the view of the SNDO, no separate assessments or consultations are necessary to set the exposure amount.

3.4.3 Setting of the recapitalisation amount

The SNDO's policy position: The recapitalisation amount shall be equivalent to a firm’s total capital requirements, including, where applicable, the Basel I floor.

As stated above, the starting point for the calculation of the recapitalisation amount is that the parts of the firm's operations that are to survive after resolution can be recapitalised at a level that meets the capital requirements for its authorisation and that are applicable after the preferred resolution strategy has been executed. The capital requirement components that are conditions for authorisation under current EU regulations and that therefore can be considered for inclusion are:

- the minimum capital requirement,
- the pillar 2 requirements,
- the Basel I floor, and
- applicable leverage requirements.

Out of the above requirements, only the minimum capital requirement and the Basel I floor are formally adopted requirements in the Swedish application of the EU capital adequacy regulations. No leverage requirement is applied and normally no formal decisions are made about pillar 2 requirements either.

Unavoidably, the minimum capital requirement has to be taken into account when setting the recapitalisation amount. With respect to the other components the SNDO takes the following policy position.

The SNDO considers that all pillar 2 components should be taken into account in calculating a firm's recapitalisation need (the recapitalisation amount). The grounds for taking this policy position are that the SNDO does not consider that it is possible to anticipate in advance what requirements will be applicable at some point in the future after the execution of the resolution strategy. Nor is there anything in the current Swedish capital adequacy regulations, either in the regulations as such or in Swedish FSA's application of them, to indicate that parts of the requirements would not be applicable after the execution of the strategy. The starting point for setting the recapitalisation amount should therefore be that the same requirements that the firm is subject to initially will be applicable after resolution.

The Basel I floor is a minimum requirement for an authorisation for Swedish firms that will continue to be applicable up until at least 2017.[12] The technical standards do not provide the resolution authority with the option of not taking account of the Basel I floor when calculating the recapitalisation amount.

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[12] See the Swedish FSA's memorandum "The Swedish FSA's handling of the Basel I floor" (*Swe: "Finansinspektionens hantering av Basel 1-golvet"*) (FI Reg no 13-13990).

As long as leverage ratio requirements are not a formal capital requirement, the SNDO considers that the recapitalisation amount should not be calculated with reference to any form of leverage based measure.

In addition to being sufficient to enable a firm to meet the conditions for authorisation, the recapitalisation amount also has to cover the recapitalisation need that exists to sustain the firm's market confidence after the execution of the preferred resolution strategy. This part of the amount shall be calculated on the basis of the applicable buffer requirements and shall, as a starting point, correspond to the whole of the combined buffer requirement. But the resolution authority can set a lower amount if

1. all or part of the combined buffer requirement is not deemed to be applicable after resolution, or
2. a lower amount is deemed to be sufficient to sustain market confidence.

The possibility of setting a lower amount because all or part of the buffer requirements are not deemed to be applicable after the execution of the resolution strategy is essentially the same issue as was discussed above concerning the exclusion of certain parts of the pillar 2 requirement. In the same way as was stated there, the SNDO considers that it is not possible to make an advance determination of what requirements will be applicable after the execution of the strategy. It is therefore not appropriate to make a downward adjustment of the amount on these grounds.

It is nonetheless possible to set a lower amount if the resolution authority makes the assessment that the condition in the second point has been met. Market confidence means that a firm is able to maintain its critical functions and its access to market financing even though its own funds immediately after the execution of the resolution strategy will potentially not be sufficient to meet the buffer requirements. In making this assessment the resolution authority shall also take into account whether the capital position after resolution is appropriate in comparison with the current capital position of peer institutions.

The technical standards are based on the assumption that the combined buffer requirement is an appropriate amount to sustain market confidence. Even if a firm's compliance with the buffer requirements is probably of importance for the willingness of market participants to provide financing, it is not the sole crucial factor. In that sense the amount specified in the standards can, to some extent, be regarded as arbitrary. In practice, the amount required to sustain satisfactory market confidence may be both higher and lower than a firm’s total applicable capital requirement.

The difficulty in assessing in advance what amount is necessary to secure market confidence makes it inappropriate to set the recapitalisation amount on the basis of the assumption that market confidence can be maintained even though a firm does not meet all the applicable capital requirements. The recapitalisation amount should therefore include the whole of the combined buffer requirement. This provides full flexibility for the SNDO to be able to recapitalise firms up to a level that corresponds to the total capital requirement if this is necessary to maintain market confidence.

3.5 Firms for which the recapitalisation amount can be set at zero

The SNDO's policy position: The recapitalisation amount shall be set at zero for the companies that the SNDO has decided shall be subject to simplified planning obligations.

As described above, the resolution authority may set the recapitalisation amount to zero for firms that the authority assesses can be wound up through bankruptcy or liquidation. This means that MREL for such firms will only consist of the loss absorption amount. Since the general rule is that this amount shall be set on the basis of the applicable capital requirements, MREL will, in these cases, never be higher than a firm's capital requirements. So for this category of companies, MREL will not entail any additional requirements over and above the applicable capital requirements.

As part of its planning work, the SNDO shall, under Section 10 of the Resolution Ordinance, determine to what extent resolution planning shall be conducted for each individual firm. It shall be possible for firms whose failure can be handled through normal insolvency procedures without a significant effect on financial markets, other firms, funding conditions or the wider economy to be subject to simplified obligations and therefore simplified planning requirements. However, firms that are planned to be managed by resolution will be subject to full planning requirements.

So whether or not a firm is to be covered by full planning requirements will be based on the same considerations as are to determine whether its recapitalisation amount should be greater than zero.

In this light, the SNDO does not see any reason to carry out a separate assessment of the firms for which the recapitalisation amount can be set at zero. Instead this policy position should be linked to the outcome of the assessment concerning simplified obligations. So this means that firms that are subject to full planning requirements will also be assigned a recapitalisation amount in accordance with the processes set our above.

Firms that are instead subject to simplified requirements will have their recapitalisation amount set at zero.

3.6 The recapitalisation amount for other firms

For other firms the SNDO will only take a policy position on a resolution strategy and an associated recapitalisation amount when the individual resolution plans are adopted. However, the preliminary assessment made by the SNDO is that at least the firms classified in capital adequacy contexts as of systemic importance (called G-SIIs and O-SIIs) will be assigned a recapitalisation amount equivalent to the scale of all of their existing operations.

3.7 Liabilities excluded from a bail-in

The SNDO's policy position: MREL should not be adjusted because certain liabilities shall or may be excluded from a bail-in.

Under the Resolution Act certain liabilities may not be bailed-in or converted in connection with resolution (mandatory exclusions).[13] Over and above this, the Act enables the resolution authority to exclude liabilities that would otherwise be eligible for bail in and conversion (discretionary exclusion) in extraordinary circumstances at the time of resolution.

The resolution authority is obliged to ensure that MREL is sufficiently high to avoid the application of these exclusion rules in resolution having the result that the quantity of bail-inable liabilities that may actually be subject to bail-in is too low. The technical standards require that this is done by the resolution authority carrying out two types of determination.

First, the authority shall ensure that the institution's loss absorption and recapitalisation capacity are sufficient even if the authority has identified a need to make full or partial discretionary exclusions of liabilities that may be included in MREL.

Second, the authority shall analyse to what extent the mandatory and discretionary exclusions identified may lead to a breach of the principle that no creditor shall be left worse off in resolution than if the firm had instead been wound up through bankruptcy or liquidation. However, this determination need only be made if the liabilities excluded account for more than 10 per cent of the firm's liabilities of equal rank to the excluded liabilities in insolvency.

[13] Chapter 21, Section 2 and Chapter 2, Section 2 of the Resolution Act

These requirements apply not only to the application of the bail-in tool but also in relation to firms whose resolution plan anticipates that resolution will be executed by the resolution authority transferring parts of the firm's operations to a new principal and transferring eligible liabilities in full without any bail in as part of this.

The technical standards do not specify which measure or measures the resolution authority should take to rectify any deficiencies identified in this process. But a number of alternatives are given in the recitals to the standards. They state that the resolution authority can either 1) set a higher MREL, 2) require that parts of MREL be met by subordinated contractual bail-in instruments or 3) take alternative measures to address impediments to resolution.

The alternative of setting a higher MREL risks being an ineffective measure for the purpose, especially if the need to take the measure stems from the fact that the exclusions are expected to lead to a breach of the principle that no creditor shall be left worse off in resolution than if the firm had instead been wound up through bankruptcy or liquidation. Since an increase in MREL would not affect the outcome for the creditors affected, the measure will only have the intended effect if it means that the firm alters the composition of its liabilities, for example by reducing liabilities that may be excluded or by increasing liabilities that will not be excluded. But even in the case where the need for measures stems from an insufficient quantity of bail-inable liabilities on account of anticipated discretionary exclusions, an MREL increase risks being ineffective if the institution chooses to meet the higher requirement by using other debts that may also be subject to discretionary exclusions.

In this light, the view of the SNDO is that the alternative of increasing MREL is not an appropriate measure for the purpose.

What is required instead is measures that target characteristics of the bail-inable liabilities used to comply with MREL. In section 7 the SNDO sets out a number of principles linked to how MREL is met that are of central importance in a determination of whether firms are deemed to be resolvable. One of these principles concerns subordination of other liabilities, and, as stated in that section, the SNDO sees advantages in eventually introducing a requirement that MREL liabilities must be subordinated. In practice such a requirement would eliminate the problem that the quantity of bail-inable instruments may be insufficient due to exclusions from bail-in. As a result, no special measures aimed at handling the consequences of rules concerning exclusions from bail-in would be necessary.

3.8 Adjustment for contributions from the deposit guarantee scheme

The SNDO's policy position: MREL should not be adjusted for contributions from the deposit guarantee scheme.

The technical standards permit deductions from MREL on account of expected contributions from the deposit guarantee scheme to the financing of a resolution process. Such deductions shall be based on an assessment of potential contributions and shall also

- be less than a prudent estimate of the potential losses that the deposit guarantee scheme would have had to bear in normal insolvency proceedings,
- be less than the limit on deposit guarantee scheme contributions to the financing of resolution[14],
- take account of the overall risk of exhausting the available financial means of the deposit guarantee scheme, which needs to be used for multiple cases (resolution or bankruptcy), and
- be consistent with any other national regulations, duties and responsibilities that apply to the deposit guarantee scheme.

The rules of the Bank Recovery and Resolution Directive regarding the contribution of the deposit guarantee to resolution have been implemented in Swedish law through Sections 7 and 7 a of the Deposit Guarantee Act (1995:1571). These provisions state that the financial means of the deposit guarantee scheme can be used for both loss absorption and recapitalisation. At the same time, such deductions can only be considered if the deposit guarantee scheme can actually be expected to be used for loss absorption or recapitalisation, i.e. in cases where the loss absorption and recapitalisation needs are expected to be so great that, without protection, covered deposits would have had to be bailed-in or converted.

As stated above, the view of the SNDO is that that the capital requirements set by Swedish FSA, should be used, less the combined buffer requirement, to set the size of the loss absorption amount. Since this means that the whole of the loss absorption amount will be covered by capital, the deposit guarantee scheme will not need to be used for loss absorption. For this reason no deduction can be considered from the loss absorption amount.

[14] See the draft of Section 7 b of the Deposit Guarantee Act (1995:1571) in Government Bill 2015/16:106 Reinforced deposit guarantee.

As regards the recapitalisation amount, in contrast, deductions may have to be made if the estimated recapitalisation need is so great that, in the absence of protection, it would have been necessary to use the covered deposits for conversion.[15] However, for such deductions to be permissible, it must be possible to establish in advance that resolution will not leave owners and creditors worse off than they would have been in a bankruptcy. This is because otherwise the condition that the contribution of the deposit guarantee scheme has to be less than the amount that would have to paid out in a bankruptcy would not be met.

Even though the SNDO judges it likely that resolution will preserve value in the great majority of cases, it is not possible to assume that it will always do so. For this reason the SNDO does not intend to grant any deductions from MREL for contributions to the deposit guarantee scheme.

3.9 Adjustment on the basis of size and systemic risk

3.9.1 General comments about the possibility of using the resolution reserve

For firms whose failure may be a threat to financial stability the resolution authority shall take particular account of the rules for executing a bail-in when it sets MREL (Article 44 of the Bank Recovery and Resolution Directive).[16] This article regulates both the mandatory and discretionary exclusions from bail-in and the circumstances under which the resolution authority may use the resolution reserve to cover losses and recapitalisation needs in resolution.

Before the resolution reserve may be used shareholders and creditors must have contributed an amount to covering losses and recapitalisation that is equivalent to at least 8 per cent of the firm's total liabilities or 20 per cent of its risk-weighted assets. If the MREL decided by the resolution authority is insufficient to reach any of these thresholds or if the resolution authority chooses to exclude certain eligible liabilities on a discretionary basis, situations may potentially arise in which there is not enough loss absorption and recapitalisation capacity in the firm to make an effective resolution process possible. In such a situation the resolution authority may, given that it is not possible to use the resolution reserve, be forced to

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[15] Since covered deposits have a right of priority, such deductions can only come into question for firms whose financing (over and above capital) consists largely or wholly of deposits. For other firms there will be other liabilities that cover the recapitalisation needs.

[16] The firms referred to are firms that 1) the supervisory authority has classified as globally systemically important institutions (G-SIIs) or other systemically important institutions (O-SIIs) and 2) other firms that may, in the assessment of the supervisory authority or the resolution authority, constitute a systemic risk, with a reasonable degree of likelihood, if they fail.

bail-in or convert liabilities that are judged, for some reason, to be unsuitable for bail-in or conversion.

However, the technical standards do not say how the resolution authority is to take the rules concerned into account when it sets the minimum requirement.

3.9.2 Need for adjustment

The SNDO's policy position: No account should be taken of the possibility of using the resolution reserve for loss absorption or recapitalisation in a resolution process when MREL is set.

The SNDO's interpretation is that this is a matter of an assessment in two stages. Fist, a determination is made of the extent to which there is a non-immaterial risk that situations will arise in which the loss absorption and recapitalisation capacity of firms risks being insufficient at the same time as the resolution reserve cannot be used. If there is such a risk, consideration should be given to whether MREL should be calibrated so as to be able to ensure use of the resolution reserve, i.e. starting from the thresholds of 8 per cent of total liabilities or 20 per cent of risk-weighted assets.

As regards the first assessment, the SNDO notes that a number of other circumstances need to be in place for a situation to arise in which there is insufficient loss absorption and recapitalisation capacity at the same time as the resolution reserve cannot be used.

First, the loss levels and recapitalisation needs have to exceed the estimated loss absorption and recapitalisation amounts or the resolution authority has to be forced to make discretionary exclusions from bail-in that were not anticipated in resolution planning.

For the loss levels and recapitalisation needs to exceed the estimated figures, given how the size of the loss absorption amount will be set, will require loss levels that have very rarely occurred historically.[17]

The probability that a situation would arise in which the SNDO is forced to make unforeseen exclusions from the bail-in of MREL compatible liabilities is also to be regarded as low. This is because, as part of its planning work, the resolution authority will regularly examine the possibility of bailing in eligible liabilities and will, when required, ensure that firms take appropriate measures (see section 3.7).

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[17] http://www.fsb.org/wp-content/uploads/TLAC-Summary-of-Findings-from-the-Impact-Assessment-Studies-for-publication-final.pdf

Second, there must also be no other bail-inable eligible liabilities (apart from those that may be used to meet MREL) or that those liabilities are also excluded from bail-in on a discretionary basis.

Even if it is theoretically possible for a firm not have to have any other eligible liabilities at all, it does not appear to be particularly likely. The data underlying the analysis presented in section 9 confirm that Swedish firms hold considerable volumes of eligible liabilities in addition to those required to comply with MREL. For the same reasons as given above with respect to MREL liabilities, it cannot be regarded as likely that a need to use the resolution reserve would arise as a result of discretionary exclusions of eligible liabilities.

It can also be noted in this context that costs may be met from the resolution reserve in cases where the resolution authority has, in its planning, made incorrect estimates of the outcome for non-excluded creditors in bankruptcy and has, as a result of this, has not increased MREL or demanded other measures that remove the risk that these creditors will be left worse off in resolution than in bankruptcy or liquidation. Even though this is not a desirable situation, it does not present any impediment to the use of the resolution reserve. This is because, under Swedish law, the threshold level for use of the reserve does not apply to the payment of compensation to creditors who have been left worse off in resolution than in bankruptcy or liquidation.[18]

So, overall, it can be noted that exceptional circumstances are required for a situation to arise in which the loss absorption and recapitalisation capacity in firms is insufficient at the same time as the resolution reserve cannot be used. The need to calibrate MREL on the basis of the thresholds for use of the resolution reserve therefore appears to be limited.

A couple of other aspects that provide more direct arguments against such a calibration can also be added to this conclusion.

First, it is not certain that use of the resolution reserve will be possible even if one of the threshold values has been met. This is because any such use has to be examined by the European Commission on the basis of the state aid regulations. Moreover, the exclusions that may require use of the reserve must be consistent with the Commission's delegated regulation on exclusions from bail-in.[19] So the fact that the a need to use the reserve

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[18] See Govt bill 2015/16:5, p. 655.

[19] Commission delegated regulation (EU) …/... of 4.2.2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council

arises does not, in itself, guarantee that it will actually be possible to use it, even if the level of the loss absorption and recapitalisation need is large enough to meet the threshold.

Second, the Directive requires that contributions by shareholders and creditors to loss absorption and recapitalisation are measured *at the point of resolution*. Given the very high likelihood that a firm placed under resolution will have made losses before that point in time and thereby consumed all or part of its capital, a requirement of 8 per cent of total liabilities or 20 per cent of risk-weighted assets would be insufficient in the great majority of cases. Therefore, to ensure access to the resolution reserve, either 1) this requirement must be supplemented with a component, over and above the threshold amounts, that takes account of the losses that can be expected to be incurred before a resolution process begins or 2) firms must be required to meet the whole of the threshold amount using MREL liabilities that must not be included in their own funds. Each of these alternatives would, for most firms, result in an MREL significantly higher than the requirements calculated on the basis of the other criteria. This is particularly true if MREL is calibrated on the basis of the 8 per cent threshold.[20]

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establishing a framework for the recovery and resolution of credit institutions and investment firms.

[20] Assuming that MREL is to be designed on the basis of the possibility of using the resolution reserve, it would be preferable in terms of flexibility to calibrate it on the basis of the 8 per cent threshold. The reason is that for it to be possible to use the resolution reserve at the threshold of 20 per cent of risk-weighted assets the balance in the reserve must be at least 3 per cent of the total covered deposits in the bank system. In addition, the 20 per cent threshold can only be applied when using the bail-in tool. Only the threshold of 8 per cent applies to the use of the government stabilisation tool, To ensure that it will always be possible to also use this tool, MREL must thus be calibrated on the basis of this threshold.

4 Breaches

4.1 Regulation in EU law

The Bank Recovery and Resolution Directive does not contain any specific provisions regarding breaches of MREL.

4.2 Swedish law

Chapter 4, Section 12 of the Resolution Act states that the SNDO shall monitor that firms meet MREL. The preparatory work to the Act also states that the Swedish FSA has the task of supervising compliance with MREL and, where relevant, deciding on measures to remedy non-compliance with the rules. According to the preparatory works, what measures are suitable will have to be decided in the light of the circumstances in each individual case.[21]

The powers of the Swedish FSA to intervene against firms that neglect their obligations under an act of law or other statute regulating the activities of the firms are set out in Chapter 15 of the Banking and Financing Business Act (2004:297) and Chapter 25 of the Securities Market Act (2007:528).

The role of the SNDO is to monitor that firms comply with MREL. If a breach is identified, it is the task of the Swedish FSA to decide on measures, based on its powers under the Banking and Financing Business Act and the Securities Market Act. In this respect the handling of MREL does not differ from how breaches of the business regulations for credit institutions and investment firms are handled.

[21] Govt Bill 2015/16:5, p. 256.

5 Transition and timetable

5.1 Regulation in EU law

Under the Bank Recovery and Resolution Directive's entry into force provisions, the MREL regulations are applicable from 1 January 2016. The technical standards state that the resolution authority may decide a suitable transitional period, but no more than 48 months.

5.2 Swedish law

The Resolution Act entered into force on 1 February 2016. There are no special transitional regulations regarding MREL.

5.3 The SNDO's views

The need to apply a transitional period is governed by the extent to which firms need to take measures to adapt to MREL.

For firms assessed as not needing to be handled through resolution in the event of a failure, no special transitional measures will be necessary since MREL does not result in any additional requirements over and above the applicable capital requirements.

However, for firms that are expected to need to be placed into resolution if they fail, MREL will exceed their capital requirement. To the extent that these firms do not have capital and bail-inable liabilities equivalent to the level of MREL, it will be necessary for these firms to issue MREL instruments that can be counted towards the requirement or to adapt their activities in some other way so as to comply with MREL.

As stated in section 9, the SNDO has gathered data from a number of firms in order to evaluate the consequences of the policy positions taken in this memorandum. The analysis carried out by the SNDO using this data shows that all firms currently have sufficient MREL instruments to comply with the quantitative level of MREL.

This indicates that there is no need to use the full permitted transitional period of 48 months. At the same time, it is not reasonable to demand that MREL calculated according to the method set out in Section 3 should start to apply immediately. The SNDO therefore intends to set an MREL that is equal to the applicable capital requirement until the end of 2017. Thereafter MREL will be set according to the calculation method set out in section 3.

Box 2 Calculation of MREL

The following table shows how MREL will be calculated according to the method described in section 3. The calculation uses a hypothetical example (Bank A), but broadly reflects the situation for a major Swedish bank.

	Calculation of MREL	**% Risk weighted exposures**
	Total capital requirements	20,0%
	minus systemic risk buffer	-3,0%
Combined buffer requirement	*minus* counter cyclical buffer	-0,5%
	minus capital conservation buffer	-2,5%
	minus systemic risk add-on in Pillar 2	-2,0%
	Loss absorption amount (LAA)	**12,0%**
	Total capital requirements	20,0%
	(inga deductions)	-
	Recapitalisation amount (RCA)	**20,0%**
	MREL	**32,0%**

The starting point for the calculation of MREL is that both LAA and RCA have to correspond to the capital requirements that apply to the firms (20% for Bank A), i.e. MREL must be twice a firm's capital requirement.

However, as stated in section 3, the SNDO intends to make certain adjustments to MREL, by excluding the combined buffer requirement and systemic risk add-on in pillar 2 from the calculation of the LAA. However, no adjustments will be made in the calculation of RCA.

In all, this means that Bank A's MREL will be 32% (made up of 12% LAA and 20% RCA).

It should be noted that the deductions from the capital requirement in the calculation of the loss absorption amount do not mean that firms need less loss-bearing capital. The capital requirements are still applicable alongside MREL. Box 3 gives a more detailed description of how the interaction with the capital requirement works.

6 Compliance with MREL – legal basis

6.1 Swedish law

The characteristics that debts must have to be able to be used to meet MREL are stated in Chapter 2, Section 2 of the SNDO's Resolution Regulations (MREL liabilities). In addition to these mandatory conditions the Resolution Act gives the SNDO the right to decide that part of MREL may be met by what are called instruments for contractual bail-in ("contractual subordination").[22]

In addition, under Chapter 3, Sections 10–11 of the Resolution Act the SNDO's resolvability assessment shall include an examination of the volume and type of eligible liabilities in firms. Pursuant to this assessment the SNDO can, if required, order firms to take measures to remove material impediments to resolution. Regarding compliance with MREL specifically, the resolution authority can deal with impediments by, for example, ordering firms to issue eligible liabilities or take other measures to comply with MREL. The resolution authority can also require a firm to set up a holding company that can be used to achieve structural subordination of MREL liabilities. Finally, to counter contagion effects that may arise as a result of holdings of other firms' eligible liabilities the resolution authority can require a firm to limit its maximum individual and total exposures.

More detailed provisions about what considerations are to be taken into account in the resolvability assessment are set out in Section 9 of the Resolution Ordinance and the technical standards to be adopted under Article 15(4) of the Bank Recovery and Resolution Directive.[23] The measures that the SNDO can order a firm to take to remove material impediments to resolution are set out in Chapter 3, Section 24 of the Resolution Act.

[22] See Chapter 4, Section 4 of the Resolution Act and Chapter 2, Section 8 of the SNDO's Resolution Regulations.
[23] On 23 March 2016 the Commission adopted a delegated regulation containing these technical standards, see http://ec.europa.eu/finance/bank/docs/crisis-management/160323-delegated-regulation_en.pdf

7 Compliance with MREL – the SNDO's views

The SNDO's policy position: The SNDO will, as a specific part of the resolvability assessment process, evaluate how firms meet MREL. For the firms that are planned to be managed by resolution, it is expected that this evaluation will be carried out on the basis that the following principles should be complied with in order for the firms to be deemed resolvable.

Liabilities proportion: Firms should have MREL liabilities that are at least equivalent to the recapitalisation amount.

MREL liabilities within groups: MREL liabilities for groups where the preferred resolution strategy is an SPE should meet certain specific criteria. Liabilities that are used to meet MREL on a consolidated basis should be issued by the parent undertaking and be held by third party entities outside the group. Liabilities that are used to meet MREL of subsidiaries on an individual basis should consist solely of liabilities to the parent undertaking. In addition, these liabilities should be subordinated to the subsidiary's other liabilities and should be capable of being written down or converted without the subsidiary needing to be placed into resolution.

The SNDO intends to assess firms' resolvability on the basis of these principles from autumn 2017. For firms that do not comply at that time with these principles, the SNDO will, unless otherwise shown, conclude that an impediment to resolvability applies and accordingly initiate a process to address the impediments.

Subordination and cross-holdings

Two further principles which the SNDO considers should be complied with in order for firms to be deemed resolvable are that:

- MREL liabilities should be subordinated to other liabilities, and
- risks related to holdings of other institutions' eligible liabilities and/or MREL liabilities ("cross-holding") should be limited.

However at this stage, the SNDO does not intend to introduce requirements related to these principles or apply them as part of the resolvability assessment. The reason for this is that the SNDO considers that further impact assessment analysis is required and additionally wishes to take account of ongoing international regulatory activity before a final decision on these matters is made. Regarding a subordination requirement, the SNDO's view is that such a requirement should be introduced in the future. The SNDO is planning to publish further information at the start of 2017 regarding *the nature, extent and implementation timetable* for such a requirement.

7.1 General principles for ensuring resolvability

MREL sets a quantitative requirement for the minimum loss absorption and recapitalisation capacity that every individual firm must have. This requirement is a fundamental prerequisite for firms to be "resolvable", .i.e. able to be wound up or restructured through resolution without this leading to serious disruptions in the financial system and without the need for government support action.

However, MREL is not sufficient by itself to ensure the resolvability of firms. One central part of the planning obligation of the resolution authority is therefore to make a resolvability assessment. With respect to MREL this assessment includes an evaluation of *how* MREL is met so as to ensure that this requirement has the intended function.

In this context the SNDO wishes to set out a number of general principles directly linked to MREL that influence whether firms can be regarded as resolvable. These principles concern:

- Liabilities proportion: the proportion of MREL liabilities in relation to total MREL.
- The location and type of MREL liabilities in groups
- Subordination of MREL liabilities
- Cross-holdings of eligible/MREL liabilities

7.2 Liabilities proportion

The SNDO's policy position: Those firms that are not deemed to be capable of being wound up through bankruptcy or liquidation and that could therefore be placed into resolution should, to be regarded as resolvable, have MREL liabilities equivalent to their recapitalisation amount.

7.2.1 General comments on the liabilities proportion principle

Under the Resolution Act MREL may be met using both own funds instruments and MREL liabilities. But the Act does not contain any explicit provisions about the mix of own funds and liabilities in MREL. However, the Act does give the resolution authority the power, as part of its resolvability assessment, to evaluate the extent to which the quantity and type of eligible liabilities held by a firm provide satisfactory assurance that a resolution can be executed. Since MREL liabilities consist of certain types of eligible liabilities, this means that the evaluation also covers the number and type of MREL liabilities.

The mix of own funds and MREL liabilities can be of importance for a firm's resolvability. This is because a bail-in can only be applied to achieve the aim of continuing a firm's operations if, at the point of recapitalisation, the firm still has sufficient own funds and eligible liabilities to restore its own funds to the level necessary to comply, after resolution, with the capital requirement needed for continued authorisation and to retain market confidence.

To ensure that this is possible the firm must either have eligible liabilities equivalent to its RCA or, if all or part of its RCA is met from own funds instruments, still have a sufficient quantity of such instruments at the point of recapitalisation. The second alternative assumes that a resolution decision is taken well before all own funds have been consumed by losses.

Considering that the capital requirements have purposes other than ensuring a firm's recapitalisation capacity in resolution, the SNDO considers that it is inappropriate to comply with MREL in a way that assumes that there must always still be a certain quantity of own funds instruments at the time of resolution/recapitalisation. Instead it is preferable to ensure a firm's recapitalisation capacity by requiring firms to hold a sufficient quantity of MREL liabilities. This design focuses on the purposes of MREL's two components: a part consisting of own funds instruments to cover losses and a part consisting of MREL liabilities that can be bailed-in so as to restore own funds.

If a firm always holds a sufficient quantity of MREL liabilities, this ensures that there will always be a certain quantity of instruments that can only be used after the firm has been placed into resolution (for recapitalisation), see box 3 below. This will enable the SNDO to ensure that there will always be sufficient MREL liabilities to absorb losses and recapitalise the firm in a resolution process. So the SNDO will not be as dependent on how much own funds remain in the firms at the point of resolution.

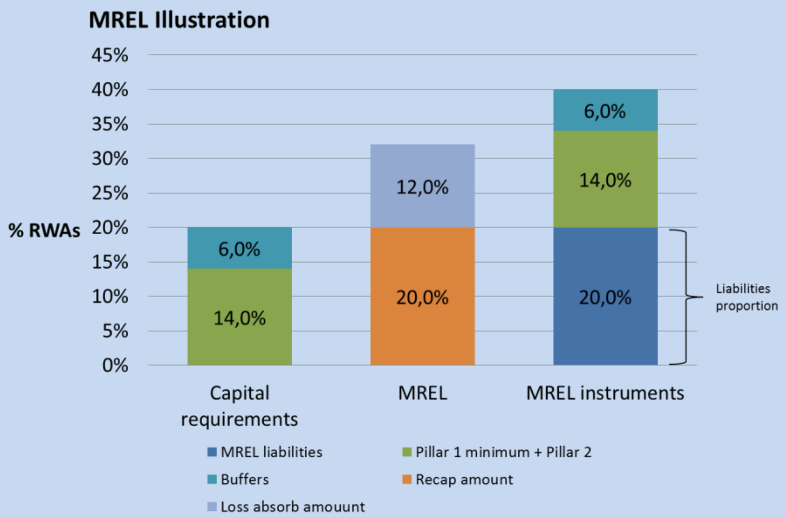
In the light of the above the SNDO considers that the firms that are expected to be placed into resolution should – in order to be deemed to be resolvable – have MREL liabilities at least equivalent to the size of their RCA.

As already noted in section 3, the effect of this principle is that the firms will not be able to count all of their existing own funds in order to comply with MREL. Not allowing firms to count parts of their capital twice in this way means, in practice, that the combined buffer requirement is placed on top of MREL. One consequence of this is that it will be possible for firms to use this capital without breaching MREL. A design of this kind thus allows the capital buffers to fulfil their intended purpose, i.e. to be an actual buffer against losses without this resulting in breaches of the capital requirements that apply for the firm's authorisation. So, in functional terms the liabilities proportion requirement has the same effect as a restriction on using the same capital that is used to meet the capital buffers to meet MREL.

Box 3 Compliance with MREL

Box 2 describes how the SNDO will calculate MREL for a hypothetical major bank. This box describes how the bank shall *meet* MREL and, more specifically, what effect the liabilities proportion principle (see section 7.2) has.

The diagram shows Bank A's capital requirement and MREL. In addition, the MREL instruments column gives a simplified illustration of how the bank can choose to meet MREL.



As stated above, the SNDO intends to apply a principle that firms should, to be regarded as resolvable, meet MREL up to a certain level with MREL liabilities. This level must be equivalent to the size of RCA, which is equivalent to 20 per cent of risk-weighted assets for bank A.

The liabilities proportion principle enhances the likelihood of being able to execute a resolution but also results in the combined buffer requirement retaining its intended function. This effect is achieved because the liabilities proportion principle means that firms will, on account of their capital requirements, have a certain quantity of capital (equivalent to at least the size of their buffers) that cannot be used to meet MREL. So this capital will be in addition to MREL and will therefore also be available for use without the firm breaching MREL.

7.2.2 The liabilities proportion in groups

For groups where the preferred resolution strategy is an SPE strategy the liabilities proportion principle will only be applied with respect to meeting MREL on a consolidated basis.

7.2.3 The remaining maturity of MREL liabilities

Under the SNDO's Regulations MREL liabilities must have a remaining maturity of at least one year.[24] To handle the refinancing risks that arise because firms are able to use fixed-maturity liabilities to comply with MREL, the SNDO considers that it is important that firms have a remaining maturity of their MREL liabilities that is longer than the minimum requirement of one year. The SNDO will therefore take a closer look at the need for further regulation of the remaining maturity of MREL liabilities.

7.3 The location and type of eligible liabilities in groups

The SNDO's policy position: MREL compatible liabilities for groups where the preferred resolution strategy is an SPE should meet certain specific criteria. Liabilities that are used to meet MREL on a consolidated basis should be issued by the parent undertaking and be held by third party entities outside the group. Liabilities that are used to meet MREL of parent undertaking. In addition, these liabilities should be subordinated to the subsidiary's other liabilities and should be capable of being written down or converted without the subsidiary being placed into resolution.

Resolution action taken against private legal persons and the capital and liabilities that may be counted towards compliance with MREL must therefore be located in the legal entities where the losses are expected to be incurred. The main impact of this is on how MREL for groups has to be met for a group to be considered resolvable. The principles that should apply to how such groups comply with their MREL depends on the resolution strategy that is expected to be applied.

For a group with an MPE strategy it is not necessary to set any requirements over and above those that already follow from the Resolution Act and associated legal instruments.

But for a group where the preferred resolution strategy is based on only the parent undertaking being placed into resolution, i.e. an SPE strategy, the liabilities of group companies should have certain special characteristics for the group to be deemed to be resolvable.

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24 Chapter 2, Section 2, point 5 of the SNDO's Resolution Regulations (RGKFS 2015:2).

7.3.1 Parent undertaking

For a group with an SPE strategy the parent undertaking should have sufficient loss absorption and recapitalisation capacity to bear the group's losses on a consolidated basis, i.e. losses both in its own operations and in other group companies. In addition, the liabilities used to comply with MREL on a group basis should 1) be issued by the parent undertaking and 2) be held by non-group companies (i.e. parties not included in the group).

The reason why there should be sufficient MREL liabilities for the parent undertaking that are held by external parties is that a write down of internal liabilities, i.e. liabilities held by another group entity, would not have any effect on the capital situation of the group.

The reason why the liabilities used to comply with the group's MREL should be issued by the parent undertaking is that this is the only way of ensuring that the strategy of keeping the group intact through resolution can be executed. If external liabilities issued by subsidiaries were used this could, in fact, result in ownership and control being transferred from the parent undertaking to the creditors of the subsidiaries when liabilities are written down and converted, which could lead to the group being split up, contrary to the strategy. Another reason why liabilities issued by the subsidiary should not be taken into account is that this does not provide the same flexibility in distributing capital to the parts of the group where it is needed.

7.3.2 Subsidiaries

For a group with an SPE strategy to be resolvable, the liabilities used by its subsidiaries to comply with their individual MRELs should also have certain special characteristics.[25]

An SPE strategy is based on the subsidiaries not being placed into resolution, with the result that ownership and control of them is not changed as a result of the resolution actions. This applies to both Swedish and foreign subsidiaries. To ensure that this outcome can be achieved, the liabilities used by the subsidiaries to comply with their individual MRELs should only consist of liabilities to the parent undertaking (intra-group liabilities). In addition, these liabilities should be subordinated to the

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[25] It should be noted in this context that Chapter 4, Sections 10 and 11 of the Resolution Act give the resolution authority the possibility of excluding parent undertakings or subsidiaries from MREL if certain conditions are met (the subsidiary must be excluded from supervision under Article 7(1) of the Credit Requirements Regulation and the parent undertaking excluded from the own funds requirement under Article 7(3) of the Credit Requirements Regulation). The Swedish FSA has not granted any such exclusions, and this means that at present the SNDO is obliged to decide on MRELs for all Swedish parent undertakings and subsidiaries.

subsidiary's other liabilities and should be capable of being written down or converted without the subsidiary being placed into resolution.

The SNDO will specify in further detail what characteristics this type of intra-group liabilities should have. This will be done in the light of ongoing international work by the FSB regarding TLAC in groups.[26]

7.4 Subordination of MREL liabilities

The SNDO's policy position: The SNDO considers that liabilities used to meet MREL should be subordinated to other liabilities and that a subordination requirement should therefore be introduced in the future.

Under the Resolution Act only a particular type of liabilities may be used to meet MREL. Which liabilities may be used to meet MREL, is stated in Chapter 2, Section 2 of the SNDO's Resolution Regulations. However the Act does not set any requirement that MREL liabilities must be subordinated to the other liabilities that may not be used to meet MREL.

Subordinating liabilities used to meet MREL to other liabilities can contribute in various ways to facilitating the execution of resolution. In the absence of subordination of certain types of debt under insolvency law there are two methods of putting subordination in place – structural and contractual subordination.

Structural subordination can be achieved by firms organising themselves in a holding company structure in which the liabilities of the holding company mainly consist of MREL liabilities that are sufficient to cover the loss absorption and recapitalisation needs of the whole group. In this case the holding company is thus obligated to comply with MREL for the group on a consolidated basis.

The contractual subordination requirement means that, to be MREL compatible, the debt instruments must contain contractual terms under which the liabilities are subordinated to other eligible liabilities and can be written down or converted before other eligible liabilities.

The SNDO can use its powers under the Resolution Act to put both these forms of subordination in place. As stated above, the Act enables the SNDO to require that part of MREL is met by instruments for contractual bail-in ('contractual subordination").[27] As part of its powers to ensure

[26] http://www.fsb.org/wp-content/uploads/Report-to-the-G20-on-Progress-in-Resolution-for-publication-final.pdf

[27] See Chapter 4, Section 4 of the Resolution Act and Chapter 2, Section 8 of the SNDO's Resolution Regulations.

resolvability, the SNDO is able to require that firms alter their legal structure by, for instance, setting up a holding company.[28]

Subordination establishes a clear order of priority meaning that subordinated debts are written down before non-priority debts. With such an order there is no need for the SNDO to decide on the exclusion of debts that may be difficult to value or linked to the firm's critical functions or that it may be inappropriate to write down for stability reasons. If the risk of write down is mainly borne by subordinated debts, this also facilitates the practical execution of resolution.[29]

For these reasons the SNDO's fundamental view that a subordination requirement should be introduced in the future. However, against the background of the implications of such a requirement for the financing of firms, further investigation is needed concerning how to introduce it and over which time horizon it should be introduced. At present work is also under way in the EU to decide how to incorporate the subordination requirements that follow from the FSB's TLAC standard in EU law. This work may also be of importance for the framing of these requirements.

The SNDO is monitoring and participating in various ways in the work under way in the EU regarding the question of subordination. However, at present the SNDO is not addressing *the nature, extent and implementation timetable* for such a requirement and intends to return to the matter at the start of 2017.

7.5 Limitation of the risks linked to cross-holdings

The SNDO's policy position: Risks related to holdings of other firms' eligible liabilities and MREL liabilities should be limited. However, for the time being the SNDO will not introduce such measures to limit risk.

One of the objectives of resolution is to avoid significant adverse impacts on financial stability. This includes preventing contagion in the financial system.[30] The resolution authority has to take account of this in its decisions on resolution actions as well as in the planning phase when setting MREL and in its resolvability assessment.[31]

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[28] Chapter 3, Section 24 of the Resolution Act.
[29] One important precondition for this is that the aggregate size of the losses and the recapitalisation need does not exceed the sum of the firm's capital base and MREL liabilities.
[30] See Chapter 1, Section 6, point 2 of the Resolution Act and Article 31(2), first paragraph, point b of the Bank Recovery and Resolution Directive.
[31] See Chapter 2, Section 5, first paragraph, point 4 of the SNDO's Resolution Regulations (RGKFS 2015:2) and Article 45(6) of the Bank Recovery and Resolution Directive and, regarding the resolvability assessment, Section 9, points 26 and 27 of the Resolution Ordinance.

One of the most obvious channels for contagion from a firm placed into resolution to other firms is when the bail-in tool is applied. Other firms may then incur substantial losses because these firms' exposures to the firm in resolution are written down. This can occur idiosyncratically or in a broader systemic crisis in which a firm incurs large losses on account of the write down of outstanding exposures to several problem-stricken firms. If the write downs are large enough, the outcome can be that the infected firm also fails and, depending on its importance for the financial system, may need to be managed through resolution. Even if the losses incurred through write-downs of debt are not large enough to cause the failure of a firm, the risk of contagion can generate uncertainty, leading to a loss of confidence among market participants with potential implications for the firm's access to financing and ability to maintain critical functions.

On account of the size and concentration of the Swedish banking sector such contagion can be viewed as a particular risk to the stability of the financial system. The linkages between firms entail a risk of contagion and since this can lead to serious disruptions in the financial system there is a need for regulation to mitigate this risk. At present this risk is mainly handled through the regulations for large exposures. In simple terms, these regulations provide that a firm's overall exposure to a customer or group of customers with links to one another must not exceed 25 per cent of the firm's capital.[32] This restriction is intended to enable the capital of a firm to bear, in extreme situations, a total write down/loss on an exposure to a customer that is at the limit without severely threatening the solidity of the firm.

However, these regulations do not result in the complete elimination of the risks of contagion and are chiefly to be seen as an instrument to limit the risk that a failure of a *single* firm results in other firms also failing. These rules can therefore be said to be less effective in countering contagion effects that can arise in a broader systemic crisis in which several, or even most, firms run into problems at the same time. In such a situation a firm with exposures to several problem-stricken firms could be exposed to aggregate losses that are large enough to result in a failure.

The regulatory framework for resolution therefore contains a number of provisions intended to supplement the provisions on large exposures. Under Chapter 3, Section 24, first paragraph, point 2 of the Resolution Act, the resolution authority can, as part of its resolvability assessment, order a firm to limit its maximum individual or total exposures. This can include setting limits for a firm's largest individual or total exposures to

[32] The provisions on large exposures are set out in Articles 4, 387–403, 493, 494 and 517 of the Credit Requirements Regulation.

eligible liabilities of other firms.[33] In addition, the resolution authority can, when deciding on MREL, take account of the extent to which the failure of a firm could have an adverse effect on financial stability.[34]

In principle the SNDO considers that the introduction of the regulatory framework for resolution and the bail-in tool in particular result in a need to limits the risks linked to a firm holding eligible liabilities or MREL liabilities issued by other firms. However, the appropriate way to do so depends on what requirements are set for firms regarding subordination of MREL compatible debt. In addition, international work is under way on drafting rules to specify how a firm's holdings of bail-inable instruments are to be handed, and this should also be taken into account.[35]

7.6 Application of the principles

The SNDO will evaluate the resolvability of firms on the basis of the principles of debt proportion (section 7.2) and the location and type of eligible liabilities in groups (section 7.3) as of autumn 2017.

For firms that do not comply at that time with these principles, the SNDO will, unless otherwise shown, conclude that an impediment to resolvability applies and accordingly initiate a process to address the impediments.

[33] See also Article 44(2) last paragraph of the Bank Recovery and Resolution Directive (which refers to Article 17(5) b of the Bank Recovery and Resolution Directive, which has been implemented through Chapter 3, Section 24, point 2 of the Resolution Act).
[34] Chapter 2, section 5, first paragraph, point 4 of the SNDO's Resolution Regulations and Article 45(6) f of the Bank Recovery and Resolution Directive.
[35] In this regard the Basel Committee has published a consultative document, TLAC Holdings - consultative document (www.bis.org/bcbs/publ/d342.htm).

8 Other matters

8.1 Reporting

Under Chapter 4, Section 12 of the Resolution Act the SNDO shall monitor that MREL is met on an individual basis and, where relevant, on a consolidated basis. The SNDO shall coordinate its monitoring activities with the supervision exercised by the Swedish FSA. In addition, Section 22 of the Resolution Ordinance authorises the SNDO to issue regulations about what information about bail-inable liabilities a firm shall provide to the SNDO and when it shall be provided.

The SNDO has not yet issued any such regulations but intends to issue a consultation in the future on proposed regulations regarding MREL along with instructions for reporting procedures. Briefly, the SNDO's intention is for reporting to cover the information needed to monitor compliance with MREL and with the principles set out in section 7. The SNDO intends to gather this information on a quarterly basis according to the same scheme and deadlines applicable under the Credit Requirements Regulation to reporting by firms to the Swedish FSA regarding capital adequacy and other matters. The SNDO's preliminary assessment is that firms whose recapitalisation amount has been set at zero (see section 3.5) do not need to be covered by the reporting obligation regarding the minimum requirement.

8.2 Disclosure

Access to information for market participants and other stakeholders about, for example, the capital situation and risk profile of firms plays an important role in maintaining market discipline, which is then beneficial for financial stability in general. For this reason the Credit Requirements Regulation makes extensive disclosure requirements for firms. Along with other information submitted according to the Swedish FSA's regulations[36], these requirements mean that information about, for example, the capital requirements of major Swedish firms, including their pillar 2 requirements and their own funds, has to be published on a quarterly basis.

The SNDO's assessment is that there is an equivalent need for publication of MREL information. Work is also under way in the Basel Committee on drafting international standards for public disclosure linked to TLAC.[37]

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[36] The Swedish FSA's regulations regarding prudential requirements and capital buffers (FFFS 2014:12), Chapter 8.
[37] http://www.bis.org/bcbs/publ/d356.htm

Against this background the SNDO is going conduct a thorough investigation, in dialogue with the Swedish FSA, regarding the legal basis for requiring the firms affected to publish information about MREL.

9 Effects on the firms

The SNDO has begun an analysis of what effects MREL will have on firms and intends to publish an in-depth impact analysis in connection with the coming announcement of a policy position on how subordination of MREL compatible liabilities should be put in place. The analysis conducted to date is based on information from 10 large Swedish firms that have submitted reports to the SNDO, including the four major banks, Handelsbanken, Nordea Bank, SEB and Swedbank. The outcome of this analysis has been taken into account in the policy choices set out in this memorandum.

Even though work on this analysis is continuing, the SNDO considers that there is reason to report certain preliminary conclusions at this point. Section 3 describes the implications of a resolution strategy based on debt write down with respect to the level at which MREL must be set in order to be able to execute the strategy. The information reported so far shows that all ten firms included in the analysis already have sufficient capital and MREL compatible liabilities to meet the quantitative MREL that is necessary to make the execution of such a strategy possible.[38]

If this analysis is supplemented with the principle that MREL should be met using a certain minimum quantity of MREL compatible liabilities, the picture is that seven of the ten firms comply with that principle.

[38] It should be noted that the SNDO has not made any decisions on what preferred strategy will be applied to individual firms. In that sense the calculations are hypothetical.