

European banking system

MREL in European banks

Requirement and shortfall under BRRD II

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Executive summary

On 7th June 2019, the “BRRD II”² was published in the Official Journal of the EU. The directive is a part of a larger legislative package which includes changes to both the prudential and the resolution frameworks and is colloquially known as “CRDV”. Among the key novelties, the subordination requirement is now regulated for European banks³. The deadline to comply with MREL and the subordination requirement is 1 January 2024 although the resolution authority can extend that period based on several considerations. To ensure a linear build-up, the resolution authority may set an intermediate target level for 1 January 2022. In this study, we estimate MREL capital deficits for a sample of 87 European banks (86% of European consolidated assets), aggregated by country, banks’ systemic importance, banks’ riskiness and the potential impact of Basel IV in MREL deficit:

- **MREL deficit, breakdown by country:** In absolute terms, the overall deficit is €112bn for the total sample, and the greatest deficits would be observed in France (€48bn), Italy (€13bn), Sweden (€12bn) and Spain (€11bn). In percentage points of consolidated assets, European banks need to issue 0.4% of total assets on average (1.2% of RWA), with some peripherals (Greece, Ireland, Italy and Portugal), core (France, Belgium) and northern European banking systems (Finland and Sweden) above average.
- **MREL deficit, breakdown by systemic importance:** The requirement for O-SIIs is 13bps of assets (47bps of risk weighted assets) above G-SIIs, which is mainly caused by a higher P2R. **MREL deficit** is mainly concentrated in O-SIIs and non-systemic banks, which together concentrate 63% of MREL needs of the sample and represent 47% of assets. In particular, non-systemic banks concentrate 19% of MREL needs and only represent 5% of assets.
- **MREL deficit, breakdown by BRRD II classification:** “Risky” banks would have a **greater requirement** than “no risky” banks and a greater **MREL deficit**. The difference in MREL deficit between “risky” and “no risky” banks is 496bps. Thus, “risky” banks, which represent **23% of total sample assets, concentrate 88% of total MREL needs** (top tier risky banks concentrate 70% of total MREL needs). The larger MREL deficit of “risky” banks is explained by (i) a greater requirement of “risky” banks P2R and above all (ii) a more stringent subordination requirement.
- **The interactions of Basel IV and MREL:** Under Basel IV, G-SIIs would be the most impacted and would require the biggest additional amount (€45bn), followed by O-SIIs (€38bn) and non-systemic banks (€9bn). However, in bps of RWA, non-systemic banks would have larger additional needs than O-SIIs and G-SIIs. This is caused by an increase in the subordination requirement. In particular, **the increase of the subordination requirement would be much higher for non-systemic banks (7.7%),** than for O-SIIs (6%) and G-SIIs (3.6%).
- **Impact on interest expense:** According to our calculations, the interest expense would increase in a range between 2.25% (if we only consider banks with deficit) and 3.16% (if we consider banks with deficit and rollover

¹ BBVA Regulation and Internal Control.

² Directive (EU) 2019/879 of the European Parliament and the Council of 20 May 2019 amending Directive 2014/59/EU.

³ Directive (EU) 2019/879 classifies banks in five categories, according to their size and riskiness, each with their corresponding subordination requirement: (i) G-SIIs (ii) top-tier banks (those with assets greater than 100bn) (iii) banks with assets below €100bn but assessed as reasonably likely to pose a systemic risk in the event of its failure (iv) “risky banks”, which are those G-SIIs, top-tier banks and banks with assets below €100bn among the top 20% in terms of riskiness and (v) others.

costs of outstanding amount of debt). The MREL framework could further erode the profitability of European banks with banks in peripheral countries more exposed than banks in core countries, with the latter facing a manageable increase in costs.

Assumptions and sample

Main assumptions

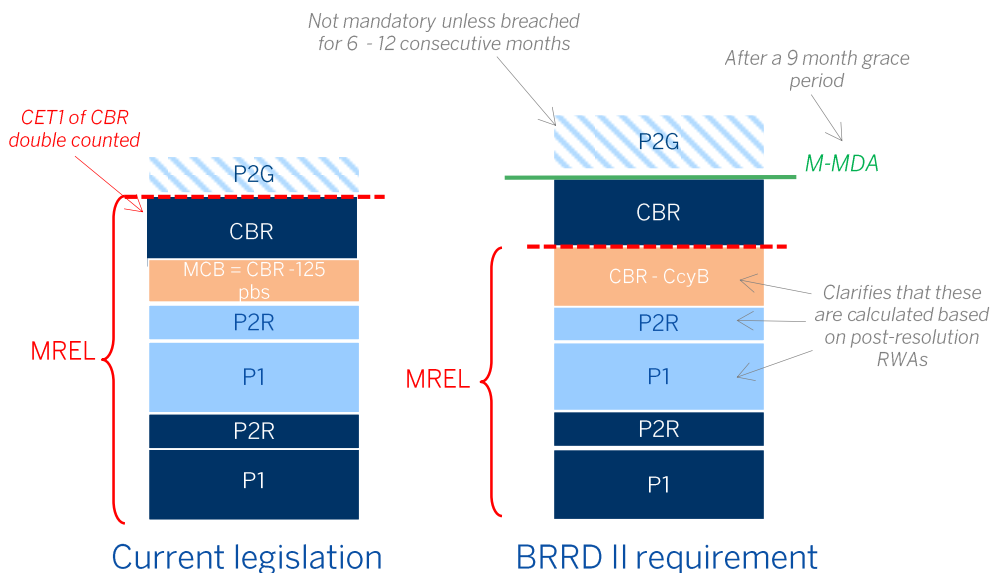
MREL requirement

Consistent with the new formula of the BRRD II, we have considered the maximum of $2(P1+P2R) + MCB^4$ in terms of RWAs or $6\% * \text{Leverage Exposure}$ at consolidated level⁵. For G-SIIs, we have applied the maximum of $2(P1+P2R) + MCB$ or $6.75\% * \text{Leverage Exposure}$. The BRRD II formula is similar to the current one set by the SRB albeit with two important differences: i) there is no double counting of CET1 used to comply with the combined buffer requirement and MREL and ii) there is no automatic reduction of 125bps to the MCB. We have set MREL on a consolidated basis for all banks⁶.

As the BRRD II states that RWAs are calculated on a post-resolution basis for both the MCB and the recapitalization amounts, we have considered the following:

- For banks following a bail-in strategy (we have assumed that those with assets greater than 50bn would follow this strategy): a downwards adjustment equal to 10% of assets to both the recapitalization and MCB amounts.
- For banks following a transfer strategy (the rest): a downwards adjustment equal to 20% of assets to both the recapitalization and MCB amounts.

Table 1. **MREL requirement under BRRD II**



4 MCB = Market Confidence Buffer (equal to the Combined buffer minus the countercyclical buffer).

5 Therefore, we have not taken into account that several banks follow an MPE approach whereby their MREL will be set on the RWAs of their sub-consolidated Eurozone resolution group.

6 Note that some banks follow an MPE strategy and their MREL is thus only set in relation to their Eurozone resolution groups, not on a consolidated basis. We have not taken this into account as there is no reliable public data.

Source: BBVA Research based on the Directive (EU) 2019/879 of the European Parliament and of the Council.

Subordination under BRRD II novelties

The subordination requirement is one of the main novelties included in the BRRD II. It will oblige banks to comply with MREL with a certain proportion of subordinated instruments (capital and subordinated debt including senior non preferred debt). The BRRD II classifies banks in five different categories, according to their size and riskiness, each with their corresponding subordination requirement:

- (i) G-SIIs
- (ii) Top-tier banks (those with assets greater than 100bn)
- (iii) Banks with assets below €100bn but assessed as reasonably likely to pose a systemic risk in the event of its failure⁷
- (iv) “Risky banks”, which are those G-SIIs, top-tier banks and banks with assets below €100bn among the top 20% in terms of riskiness⁸ and
- (v) Others.

For the purpose of this study, we have considered all banks as “top tier” even if their total assets are lower than €100bn because BRRD II allows national authorities to treat smaller banks as top tiers if they are systemic, up to a limit of 30 % of the total number of all resolution entities⁹.

Therefore, for “risky banks” we have applied the maximum of $8\% \cdot \text{TLOF}$ and $2 \cdot (\text{P1} + \text{P2R}) + \text{CBR}$ ¹⁰ and for non-risky banks we have applied the minimum of **(i)** $(1 - (X1/X2)) \cdot 8\% \cdot \text{TLOF}$ ¹¹, of which $X1=3.5\%$ of RWA and $X2=18\%$ of RWA and **(ii)** $27\% \cdot \text{RWA}$ ¹².

Eligible instruments

We have considered the following instruments as eligible towards the MREL requirement: (i) CET1 net of deductions to cover the combined buffer or P2G, (ii) AT1, (iii) Tier 2, (iv) other subordinated debt not considered as regulatory capital, (v) senior non preferred debt (i.e. contractually subordinated debt) or senior debt issued from the holding company (i.e. structurally subordinated, a model which is predominant in English and certain Dutch banks), (vi) traditional or senior preferred debt issued from the holding company.

Although non-covered non-preferred deposits (such as those from credit institutions, collective investment undertakings, pension funds, etc.) continue to be eligible if they lack an early redemption clause, we have excluded them for the purpose of our exercise¹³.

We have not taken into account whether eligible liabilities comply with the new requirements of the amended CRR as those issuances will be grandfathered until their maturity and will thus be able to be computed towards MREL. Regarding capital instruments, the revised CRR contains a six-year grandfathering clause. In our calculations we have included all these instruments regardless of their compliance with CRR II once the grandfathering period is over. Our results could thus slightly understate the real deficits, especially for AT1 instruments (because they are perpetual). Moreover, we have considered capital instruments on a consolidated basis, which are eligible under

⁷ Article 45c(6) of the Directive (EU) 2019/879 of the European Parliament and of the Council

⁸ For the purpose of assessing the riskiness of an institution, we consider the 20% of institutions with the highest Pillar 2 Requirement (P2R).

⁹ Article 45b(8) of the Directive (EU) 2019/879 of the European Parliament and of the Council

¹⁰ Article 45b(8) allows resolution authorities to apply subordination requirement set in Article 45b(7) to resolution entities that meet one of the conditions described.

¹¹ Article 45b(4) of the Directive (EU) 2019/879 of the European Parliament and of the Council

¹² We have applied the second subparagraph of Article 45b(4), which establishes the floor of $27\% \cdot \text{RWA}$ to top-tiers.

¹³ The SRB excludes non-covered non-preferred deposits if they can be withdrawn within a one-year horizon. For further details, please see [2018 MREL Policy](#)

2018 MREL Policy. However, senior issuances are considered on an individual basis, which are mainly governed by European law and thus eligible for the purposes of MREL. In this sense, we have assumed that all liabilities regardless of their governing law are eligible towards MREL but that might not be the case in the future (UK issuances will probably be considered as governed by third country law).

Sample

The sample is composed of 87 European banks (69 Euro area banks and 18 non-Euro area banks), which represent 86% of the European banking sector in terms of consolidated assets. We have considered as “risky” in each country the 20% with the highest P2R. In total, 25 banks were labelled as “risky” (29% of total banks in sample), below the threshold of 30% set in the revised BRRD¹⁴.

Table 2A. **Breakdown by systemic importance**

Country	G-SII	O-SII	Other	Total
AT		3	2	5
BE		2	1	3
CY		1		1
DE	1	8	4	13
DK		4		4
ES	1	4	7	12
FI		3		3
FR	4	1		5
GB	3	3		6
GR		4		4
IE		2	1	3
IT	1	2	8	11
NL	1	4		5
NO		1	2	3
PT		4		4
SE		3	2	5
Total	11	49	27	87

Source: BBVA Research calculations

Table 2B. **Breakdown by top tier label**

Country	Top tier	Rest	Total
AT	2	3	5
BE	3		3
CY		1	1
DE	9	4	13
DK	2	2	4
ES	5	7	12
FI	2	1	3
FR	5		5
GB	6		6
GR		4	4
IE	1	2	3
IT	5	6	11
NL	4	1	5
NO	1	2	3
PT		4	4
SE	3	2	5
Total	48	39	87

Source: BBVA Research calculations

Table 2C. **Breakdown by “risky” label**

Country	Risky	No risky	Total
AT	2	3	5
BE	1	2	3
CY	1		1
DE	3	10	13
DK	1	3	4
ES	3	9	12
FI	1	2	3
FR	3	2	5
GB	1	5	6
GR	1	3	4
IE	1	2	3
IT	2	9	11
NL	1	4	5
NO	1	2	3
PT	1	3	4
SE	2	3	5
Total	25	62	87

Source: BBVA Research calculations

Results

In this section, we present MREL shortfalls by country, by systemic importance and by BRRD II classification. For the sample considered and under the assumptions indicated above, aggregate deficit would be €112bn for the total sample (0.4% of total assets, 1.2% of RWA). Considering that in aggregate terms, from January 2018 to April 2019 banks issued €194bn of MREL-eligible debt, the current deficit seems manageable for European banks, and particularly under current very accommodative monetary policy conditions.

Breakdown by country

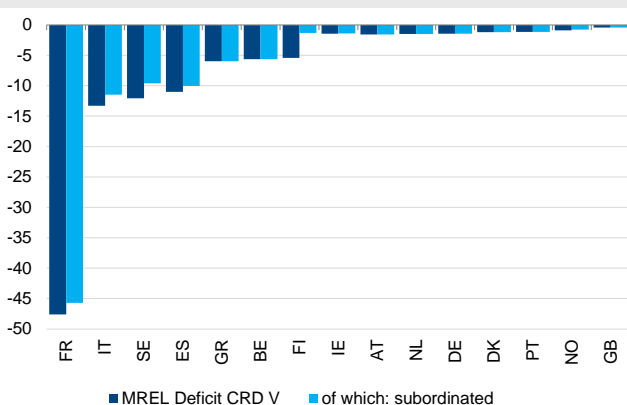
In absolute terms, the greatest deficits would be observed in France (€48bn), Italy (€13bn), Sweden (€12bn) and Spain (€11bn). In percentage points of consolidated assets, European banks need to issue 0.4% of total assets on average, with some peripherals (Greece, Ireland, Italy and Portugal), core (France, Belgium) and northern European banking systems (Finland and Sweden) above average. In pp of RWA, the same countries appear above average except Portugal, because of an above average risk weighted assets density.

¹⁴ Article 45b(8) of the Directive (EU) 2019/879 of the European Parliament and of the Council

Regarding peripherals, the deficit is mainly prompted by the limited issuances of subordinated instruments and, in particular, of senior non-preferred. In fact only Spain and Italy have outstanding amounts as of June 2019. In the period January 2018-April 2019, Spanish banks were the main issuer of this type of debt among peripherals, which partially explains the below-average deficit of Spanish banks in pp of total assets.

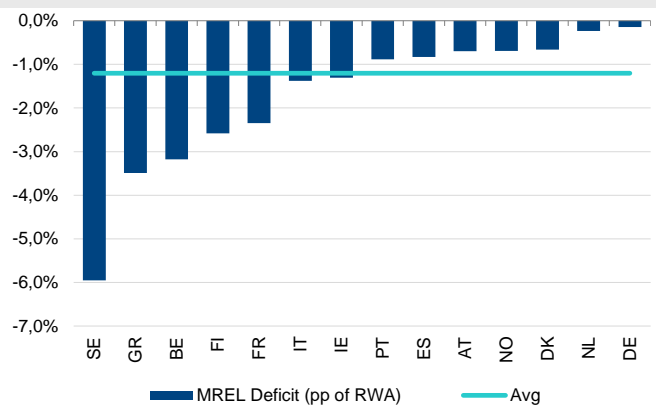
Regarding core systems, the deficit is mainly prompted by low risk-weighted assets density that make them apply the subordination requirement of 8% of total liabilities and own funds (see assumptions above) and to a lesser extent by the low stock of subordinated issuances. In any case, core systems have traditionally issued senior debt in European markets and the capacity to rollover this issuances into subordinated-type ones is high.

Figure 1A. **MREL deficit, (€ billion)**



Source: BBVA Research calculations

Figure 1B. **MREL deficit, (percentage points of RWA)**



Source: BBVA Research calculations

Breakdown by systemic importance

The **requirement** is heterogeneous between groups of entities. In pp of assets, the requirement would be higher for non-systemic banks, followed by O-SIIs and G-SIIs, respectively (Figure 2A). According to our calculations, the requirement for O-SIIs is 13bps of assets (47bps of risk weighted assets) greater than for G-SIIs, which is mainly caused by a higher P2R for O-SIIs (on average 17bps higher than for G-SIIs).

Both at global (TLAC) and European level (BRRD II), regulators demand a greater MREL requirement for G-SIIs. In this exercise, we applied the fully-loaded requirement for G-SIIs, envisaged in the Addendum to the SRB 2018 MREL Policy, which is the highest of 18% of total risk exposure amount or 6.75% leverage exposure amount¹⁵. However, the requirement for O-SIIs would be even higher, because of the larger P2R for O-SIIs.

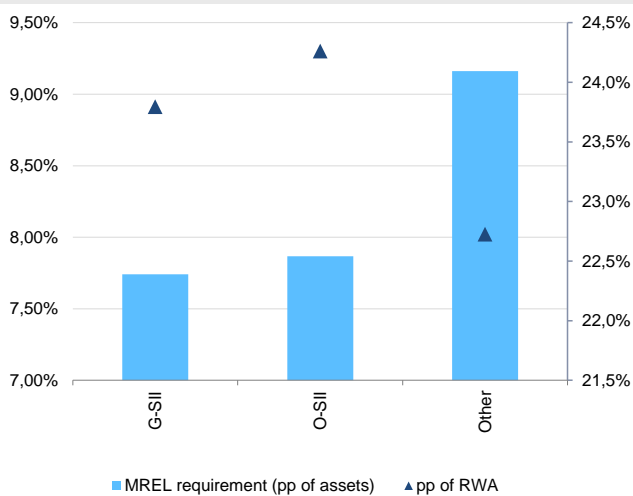
Regarding other banks, the requirement is lower in pp of risk weighted assets due to a lower P2R. However, in pp of assets, the requirement is much higher because of a higher risk weighted assets density (40.3% on average) than that of O-SIIs (32.4%) and G-SIIs (32.5%). Therefore, other banks would need to issue a larger amount of eligible debt in relation to their size.

In absolute terms, **MREL deficit** is mainly concentrated in O-SIIs and non-systemic banks (Figure 2B), which concentrate 63% of MREL needs and represent 47% of assets. In particular, non-systemic banks represent 5% of assets and concentrate 19% of MREL needs. The differences among banks are explained by the access to the

¹⁵ Applicable from 1 January 2022.

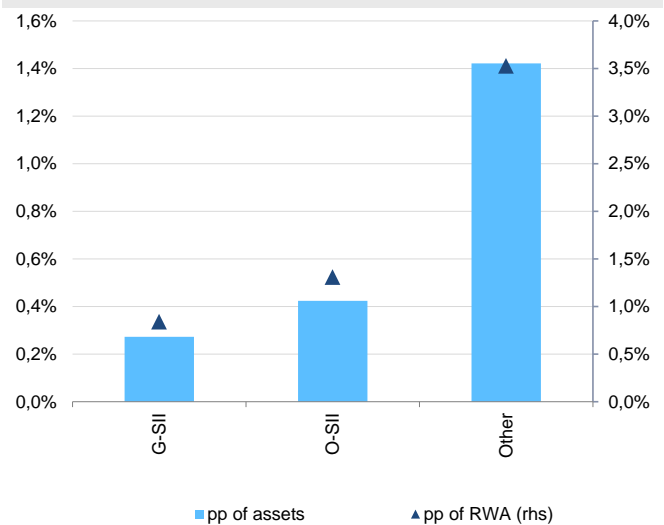
market and the outstanding amounts of eligible debt. In this sense, G-SIIs represent 67% of outstanding senior non-preferred debt, 49% of subordinated debt and 49% of senior debt while systemic entities (G-SIIs and O-SIIs) concentrate 99% of outstanding senior non-preferred, 95% of subordinated debt and 92% of senior debt. Other banks account are explained by the low outstanding amount of senior non-preferred debt as of June 2019, only 0.2% of consolidated assets (0.7% for O-SIIs and 1.1% for G-SIIs).

Figure 2A. **MREL requirement, (pp of assets and RWA, rhs)**



Source: BBVA Research calculations

Figure 2B. **MREL deficit, (pp of assets and RWA, rhs)**



Source: BBVA Research calculations

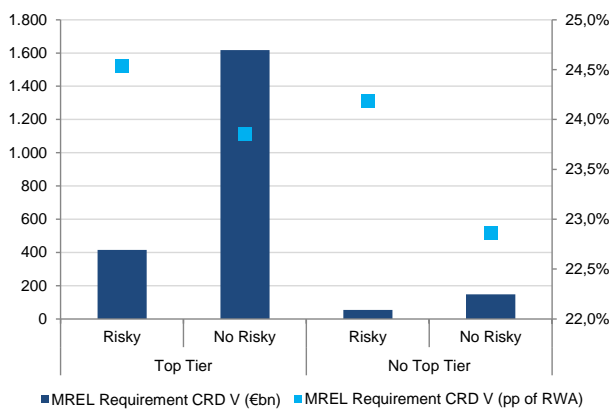
Breakdown by BRRD II classification

Top tier “risky” banks have a larger deficit than top tier “no risky” banks because of (i) higher requirement (+68bps) and (ii) higher subordination requirement.

“Risky banks” would have a greater **requirement** than “non-risky” banks (Figure 3A). The difference in MREL requirement between top tier “risky” and “non-risky” banks is 68bps of risk weighted assets (133bps for non top tiers), mainly due to the different P2R applicable (for top tier “risky” banks, P2R is around 90bps greater than for top tier “non-risky” banks).

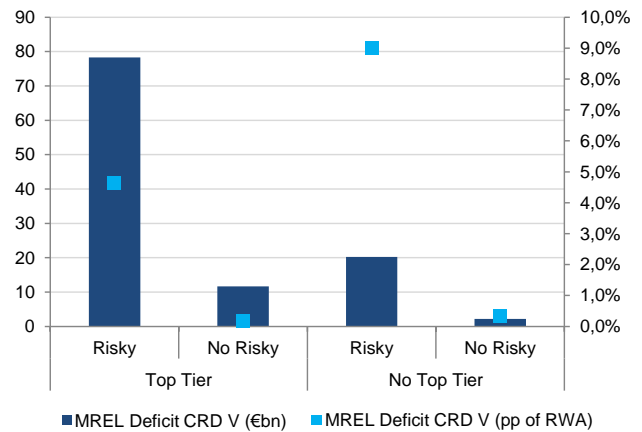
“Risky banks” would also have greater **MREL deficit** (Figure 3B). The difference in MREL deficit between top tier “risky” and “non-risky” banks is 446bps of RWA (496bps if we consider all “risky” and all “no risky” banks). Thus, “risky” banks, which represent 23% of total sample assets, concentrate 88% of total MREL needs (top tier risky banks concentrate 70% of total MREL needs). The greater MREL deficit of “risky” banks is explained by two factors. Firstly, a greater requirement. Secondly, a more stringent subordination requirement due to lower than average risk weighted assets density than “non-risky” banks (29.5% vs. 33.9%). Therefore, when establishing the subordination requirement between the greatest of (i) 8%*TLOF (exposure measure) and (ii) 2*(P1+P2R) + CBR (risk weighted assets measure), the exposure measure is larger. To illustrate, for top tier “risky banks” the subordination requirement is 8%*TLOF in all cases except for two banks. Considering all “risky banks”, more than half of the banks would have the most stringent subordination requirement (e.g. 8%*TLOF).

Figure 3A. **MREL requirement, (€bn and percentage of RWA, rhs)**



Source: BBVA Research calculations

Figure 3B. **MREL deficit, (€bn and percentage of RWA, rhs)**



Source: BBVA Research calculations

The interactions of Basel IV and MREL

The finalization of Basel III aims at enhancing the calculation of risk-weighted assets in order to improve the comparability of capital ratios. In some cases, it removes the possibility to use internal models (e.g. equities) and, in other cases, it introduces additional constraints to the use of internal models (e.g. low default portfolios)¹⁶. Therefore, risk-weighted assets are deemed to increase for most banks. The increase in risk-weighted assets affects directly to the MREL requirement and, therefore, banks would need additional issuances to comply with it. In this sense, the EBA report on impact assessment of the Basel III package¹⁷, expects a risk-weighted assets increase of 27.9% for G-SIIs, 22.9% for O-SIIs, 14% for medium banks and 6.6% for small banks. In our study, we have applied this increases and obtained, considering the other assumptions constant, the additional MREL needs.

Average risk weighted assets density would increase from 32.9% to 41.1% leading to larger MREL requirements and larger deficits. According to our calculations, Basel IV would increase MREL needs by €91bn for the sample considered

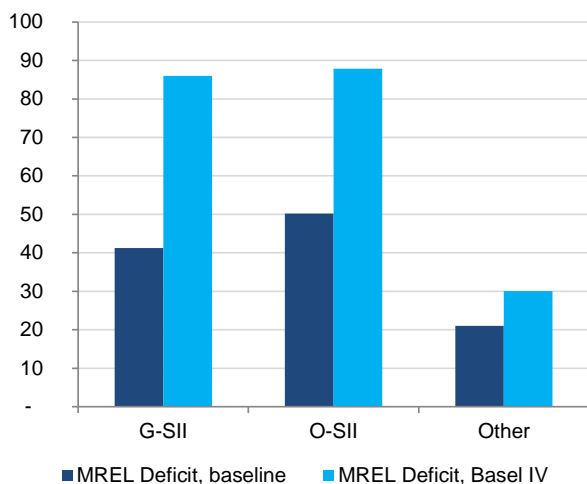
Under Basel IV, G-SIIs would be the most impacted and require the biggest additional amount (€45bn), followed by O-SIIs (€38bn) and non-systemic banks (€9bn). However, in bps of RWA, non-systemic banks would have larger additional needs than O-SIIs and G-SIIs (Figure 4B). Non-systemic banks would be more punished under Basel IV rules because their risk weighted average density would increase significantly¹⁸ and, consequently, they would have a stringent subordination requirement. In particular, the increase of the subordination requirement would be much higher for non-systemic banks (7.7%), than for O-SIIs (6%) and G-SIIs (3.6%).

16 See [Basel III: Finalising post-crisis reforms](#). December 2017. Basel Committee on Banking Supervision.

17 See [Basel III reforms: Impact study and key recommendations](#). August 2019. European Banking Authority

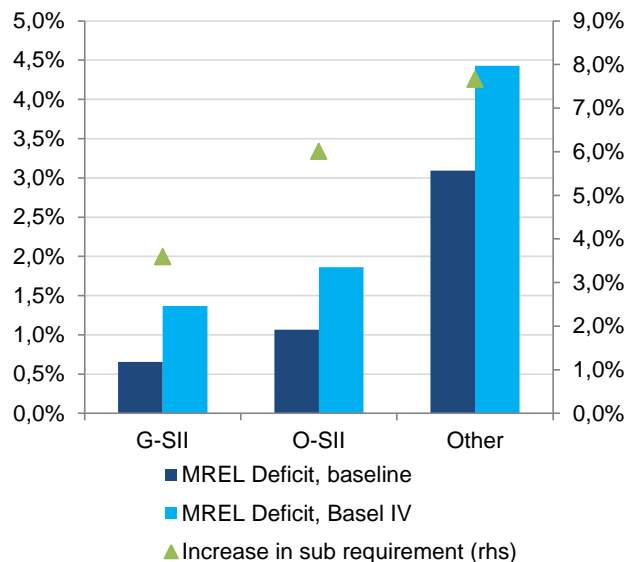
18 From 40.3% on average to 46% on average.

Figure 4A. MREL deficit, baseline and Basel IV assumptions, (€bn)



Source: BBVA Research calculations

Figure 4B. MREL deficit, baseline and Basel IV assumptions, (pp of RWA)



Source: BBVA Research calculations

The impact of MREL issuances in banking profitability

We have calculated the increase in interest expenses to comply with the required level of bail-in debt under the BRRD II framework. Firstly, we have calculated the average yield to maturity of senior non preferred, subordinated debt and traditional senior unsecured debt issued in the period January 2018-April. Secondly, we have calculated the increase in expenses differentiating by (i) banks with MREL deficit and (ii) banks without MREL deficit. For the former, interest expenses were the result of aggregating the costs of new issuances and rolling over existing ones. We assumed that the rollover would be done with senior non-preferred debt and therefore rollover costs would be the spread between senior non-preferred and senior¹⁹:

$$\text{Additional costs MREL} = \text{Deficit senior} * YTM_{sen} + \text{Deficit subordinated} * YTM_{snp} + \text{Outstndng debt} * SPREAD_{(snp-sen)}$$

For banks without MREL deficit, costs were only the result of rolling over existing issuances:

$$\text{Additional costs MREL} = \text{Outstanding debt} * SPREAD_{(snp-sen)}$$

According to our calculations, the **interest expense would increase in a range between 2.25%** (if we only consider banks with deficit) **and 3.16%** (if we consider banks with deficit and rollover costs of outstanding amount of debt). We assumed that subordinated debt deficit would be fulfilled with senior non-preferred, which is the subordinated-type issuance with the lowest associated costs (see section below). Therefore, costs would be much higher if subordinated debt deficit were fulfilled with traditional subordinated debt, which account with greater

19 For all of them, we have considered that subordinated debt deficit is fulfilled with senior non-preferred, which is, on average, the subordinated debt-type with the lowest yield to maturity. Similarly, rollover costs have been calculated with the spread of senior non-preferred and senior, under the assumption that the outstanding senior would be replaced in markets by senior non-preferred contracts

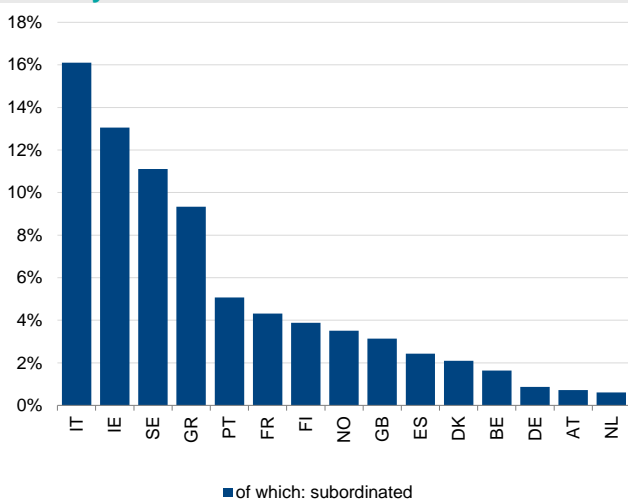
associated costs on average (see the next section). Note that only 35 banks of 10 financial systems have issued senior non-preferred in the period considered, so we could expect that some banks would have scarce access to senior non-preferred market in the future and thus they might fulfill subordinated debt deficit using traditional subordinated debt.

By systemic importance, non-systemic banks would experience an increase in interest expense of 5.6%, almost twice sample average, which would put additional pressure on their profitability. G-SIIs would be slightly more impacted than O-SIIs, because they have lower interest expense²⁰ and thus would suffer a greater increase to comply with the new requirement.

By country, particularly peripherals (Italy, Ireland, Portugal and Greece) and Sweden would increase interest expense by more than 5%. The Swedish case is particular, because they have not issued senior non-preferred debt and we have considered that subordinated debt deficit would be fulfilled with traditional subordinated debt. France appears worse than average due to higher than average YTM of senior non-preferred and a higher than average spread for the purpose of rollover costs. Core countries (Belgium, Germany, Austria and Netherlands) would experience growth rates of increase interest expenses below 1.7%.

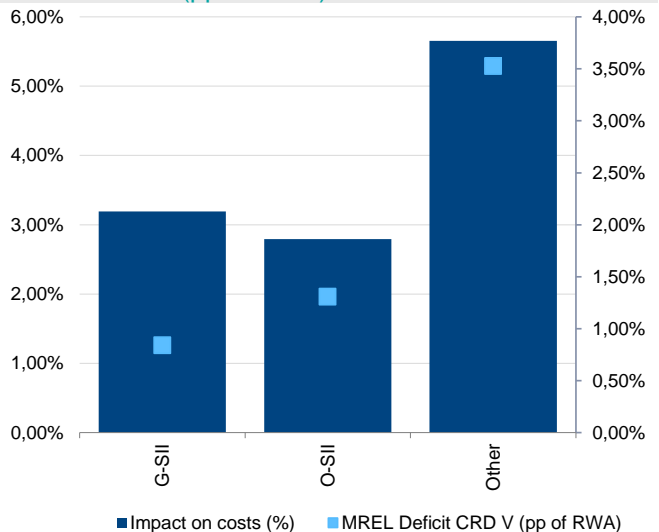
In conclusion, the MREL framework could increase the fragmentation in profitability of the European banking sector, because of the dispersion in the increase in interest expense among countries (peripherals would erode further their profitability, while core countries face a manageable increase in costs).

Figure 5A. **Increase in interest expense (%) by country**



Source: BBVA Research calculations

Figure 5B. **Increase in interest expense (%) and MREL deficit (pp of RWA)**



Source: BBVA Research calculations

²⁰ In pp of total assets

Costs of subordinated instruments

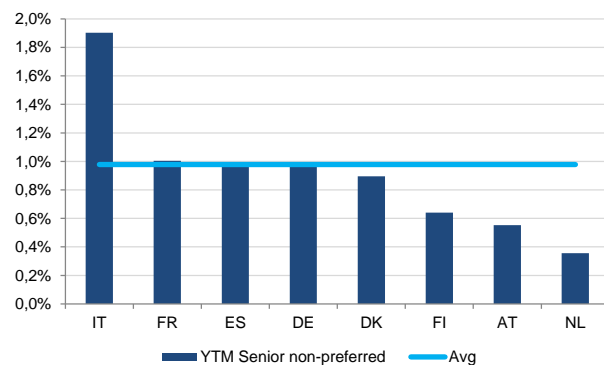
These subordinated instruments are the most expensive among MREL-eligible types of debt, which also include traditional senior debt. In this section, we analyze the costs of two types of subordinated instruments (senior non-preferred and Tier 2) by banking system and by rating, calculating the weighted average yield to maturity (YTM) of issuances in EUR during the period ranging from January 2018 to April 2019. We find that there is high dispersion in YTM among countries and ratings. Moreover, there is high correlation between rating and YTM, with increasing YTM in worse rating levels.

Senior non-preferred: the debt type with the lowest cost among subordinated issuances

In the period ranging from January 2018 to April 2019, the average YTM was 0.98%. The main issuers in the period were Germany and France, which concentrate more than 70% of issuances in EUR in the period. Regarding ratings, around 50% of the issuances in EUR are rated Baa1 or Baa2, with an average YTM slightly below average. In addition, there is high heterogeneity in YTM depending on the rating (e.g. changing from Baa1/Baa2 to A3 entails a reduction in yield to maturity of more than 50 bps and changes from Baa1/Baa2 to Ba1 increase the YTM by 50bps).

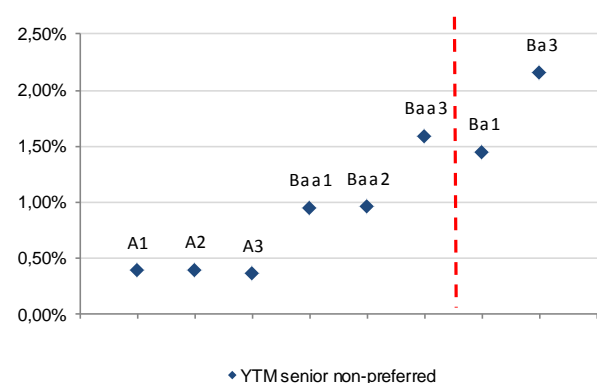
Speculative issuances have a well above average yield to maturity, but they are scarce. However, if the economic environment deteriorates and the conditions tighten, issuances are likely to be rated at lower levels, which would significantly increase issuing costs for European banks, making even more difficult to comply with MREL.

Figure 1A. **YTM of senior non-preferred issuances in the period January 2018-April 2019, breakdown by country**



Source: Bloomberg and BBVA Research calculations. The weighted average YTM per country has been obtained by weighting each bank issuance with each country corresponding issuances. Only issuances in EUR have been considered.

Figure 1B. **YTM of senior non-preferred issuances in the period January 2018-April 2019, breakdown by rating**



Source: Bloomberg and BBVA Research calculations. The weighted average YTM per rating has been obtained by weighting each bank issuance with each rating corresponding issuances. Only issuances in EUR have been considered. Dotted line divides ratings into investment grade (left side) and speculative (right side)

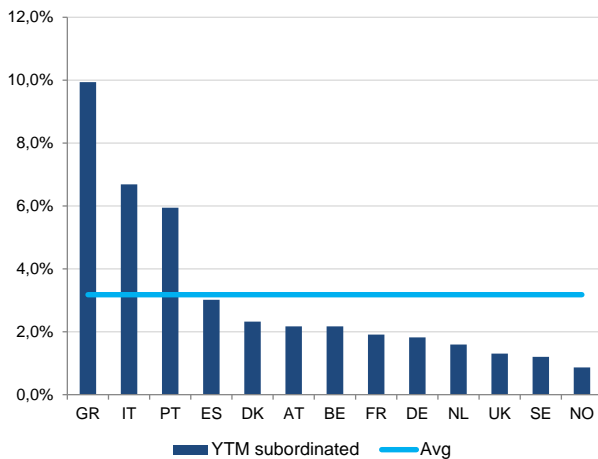
Subordinated debt issuances (mainly eligible for Tier 2)

Subordinated debt issuances are more expensive than senior non-preferred. In the period considered, the average YTM of issuances in EUR was 3.2% (vs 0.98% for senior non-preferred). Spanish, French and Italian banks were the main issuers in this period and concentrated more than half of issuances.

Regarding YTM per rating, 42% of issuances are rated Baa1/Baa2, with an average 2% YTM. In this market, changes from Baa1 to A3 entail a reduction in yield to maturity of 99bps and changes from Baa3 to Ba1

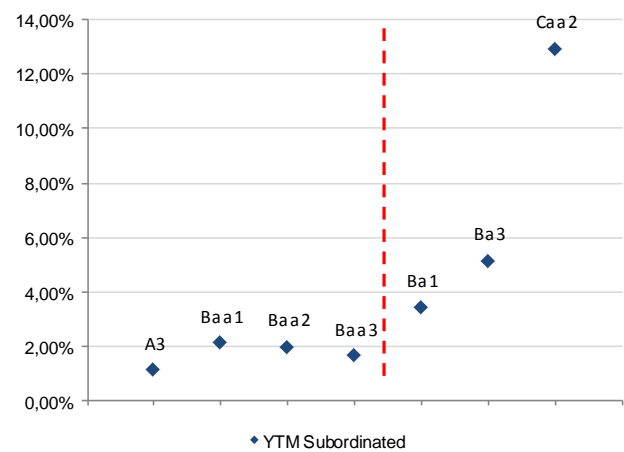
(speculative grade) entail an increase in yield to maturity of 180bps. Therefore, the differences in YTM among rating tranches are more pronounced in this market than in senior non-preferred market.

Figure 1A. **YTM of subordinated debt issuances in the period January 2018-April 2019, breakdown by country**



Source: Bloomberg and BBVA Research calculations. The weighted average YTM per country has been obtained by weighting each bank issuance with each country corresponding issuances. Only issuances in EUR have been considered.

Figure 1B. **YTM of subordinated debt issuances in the period January 2018-April 2019, breakdown by rating**



Source: Bloomberg and BBVA Research calculations. The weighted average YTM per rating has been obtained by weighting each bank issuance with each rating corresponding issuances. Only issuances in EUR have been considered. Dotted line divides ratings into investment grade (left side) and speculative (right side)

Annex: Other new requirements included in the Banking Package

Aside from the changes to the MREL formula, the eligibility criteria and the new subordination requirement, the other most relevant changes to the resolution framework included in the revised CRR and BRRD are:

Transitional arrangements

The deadline to comply with MREL and the subordination requirement is 1 January 2024 although the resolution authority can extend that period based on several considerations. To ensure a linear build-up, the resolution authority may set an intermediate target level for 1 January 2022. The grandfathering regimes for AT1 and Tier 2 instruments not complying with letters (p), (q) and (r) of art. 52 and 63 is set to 6 years after the entry into force of CRR2 and it is permanent for eligible liabilities not complying with letters (f) to (n) of art. 72b(2).

Moratorium

The package includes the power for resolution authorities to suspend the payment of principal and interest of a bank in difficulties. The moratorium tool can be applied for a period of up to 2 days in a pre-resolution scenario but after the declaration of “failing or likely to fail” to a wide range of bank liabilities including covered deposits. The agreement, although milder than the one initially proposed by the Commission (which included two moratorium tools usable for a period of up to five days each and which could be combined with the resolution stays already included in the current BRRD), goes beyond the recommendations of the FSB’s Key Attributes.

M-MDA

The resolution authority may prevent an entity from distributing dividends, AT1 coupons or variable remuneration to its employees after a grace period of 9 months if an entity is in breach of its CBR due to it not being able to rollover eligible liabilities because of a serious disturbance of financial markets.

Insolvency

Member States will have to ensure that “failing or likely to fail” would trigger insolvency proceedings if resolution action is not in the public interest (in order to avoid national regimes interfering with the decisions of EU authorities). Furthermore, national insolvency laws will have to recognize that capital instruments or instruments ranking pari passu will have to absorb losses in insolvency before other subordinated claims. These two changes are a step forward towards harmonizing insolvency regimes in the EU, a goal that must now be pursued by EU legislators in order to avoid uneven treatments in future bank resolutions/liquidations depending on their country’s origin and in order to level the playing field for banks in the EU.

Retail holdings

Selling of subordinated eligible liabilities will not be permitted to retail clients unless the buyer passes a suitability test and unless the financial instrument portfolio of that client does not exceed EUR 500.000, the client does not invest more than 10% of its portfolio in subordinated eligible liabilities and the instrument has a minimum denomination of EUR 10.000. If the minimum denomination is EUR 50.000 then the retail client does not have to comply with the preceding conditions. It is the retail client that must provide the information to the seller. Albeit these requirements only apply to subordinated liabilities (not to senior preferred debt if it is pari passu with excluded liabilities, which is the case in most EU countries), national authorities may extend them to non-subordinated eligible liabilities.

Home-host balance and internal MREL

The Council did not want to negotiate its compromise text of May 2018. As such host authorities will enjoy more power to set internal MREL than that provided initially by the Commission.

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