GIBRALTAR RESOLUTION
AND COMPENSATION UNIT

Banking Package Changes

BRRDII Changes; Briefing Note

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Today’s Content

- Background to Banking Package
- Timing of changes
- What is MREL?
- MREL Harmonisation under BRRDII
- Other MREL Changes
- Subordination Changes
- Other Banking Package changes
- UK BRRDII Consultation
- Next Steps
- Summary

Background of Banking Package

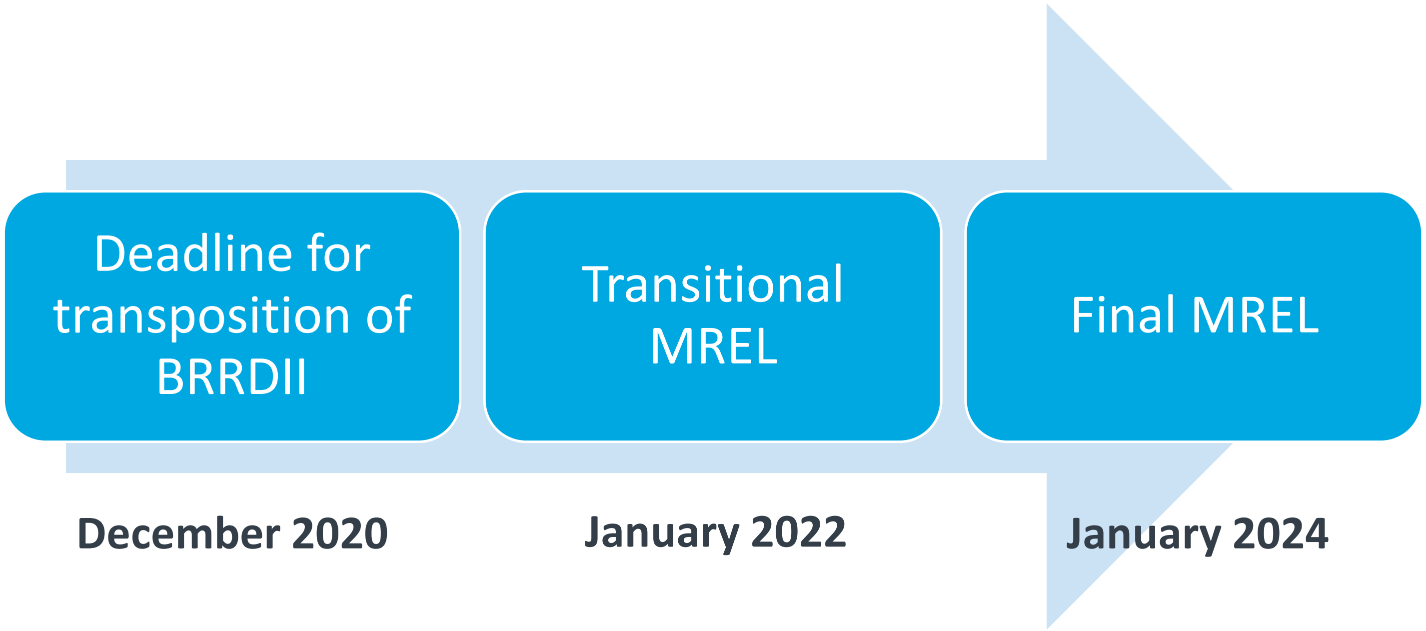
- The EU banking package consists of two Directives (the Capital Requirements Directive V (‘**CRD V**’) and the Bank Recovery and Resolution Directive (‘**BRRDII**’), and one relevant Regulation (the Capital Requirements Regulation (‘**CRR II**’).

- The objective of the package is to **further reduce risk in the banking sector by making a number of targeted amendments** to existing legislation that;
    - Incorporate outstanding elements of international level reform.
    - Improve the existing framework, following practical experiences since 2015.

- During the Transition Period, **Gibraltar will continue to implement EU legislation that requires transposition,** with the Bank Resolution Framework remaining central to international regulatory and financial stability objectives beyond 2020.

- This briefing considers the **relevant amendments for the Gibraltar banking industry under BRRDII and include the proposed implementation steps.**

Timing of Changes (BRRDII)



What is MREL?

- An overarching objective of a Bank Resolution regime is to shift the burden of bank rescues **from taxpayers to bank creditors**. Resolution Authorities (RA's) are now given the power to allocate losses to shareholders and creditors through the "bail in" tool. Shareholders and creditors must therefore absorb losses in a Bank resolution scenario.

- As of today, upon resolution, a failing institution may or may not hold a sufficient amount of bail-inable liabilities. To tackle this issue, the BRRD provides that institutions shall meet at all times **a minimum requirement for own funds and eligible liabilities** (MREL), to be determined by the RA.

- The MREL constitutes an anchor point for the resolution frameworks, as it determines the credibility of the bail-in regime. As bailing-in some liabilities may be legally difficult or potentially disruptive for the real economy, the BRRD also provides also for a list of liabilities which must **not** be bailed-in, in particular covered deposits and secured liabilities.

MREL Harmonisation (Banking Package)

- The Banking Package brings about further harmonisation with international standard when it comes to MREL.
- **MREL calibration** (previously a expressed as a percentage of total liabilities and own funds) will, under BRRDII, be expressed as a % of;
    - Risk Weighted Assets ('RWA's'), and
    - Leverage Ratio Exposure ('LRE's)
- **Minimum MREL**, where a firm has been assessed as being reasonably likely to pose a systemic risk in the event of failure a minimum MREL will now be included within BRRDII (this replaces the 'default' MREL rate). Preliminary analysis suggest limited impact on local firms vis-à-vis previous rate.

Note: *Other G-SII specific changes/standards included in banking package not relevant for Gibraltar institutions, given their size.*

Other MREL Changes (Banking Package)

- Introduction of **subordination rules** (see next slide).
- Further detail now provided on which **liabilities are eligible to qualify as MREL** & tools to achieve subordination (non-preferred senior debt category).
- Clarity on Resolution Authority **powers regarding MREL breaches** (via maximum distributable amount restrictions).
- **MREL transitional period flexibility** provided to Resolution Authorities (already applied locally).
- **MREL regulatory reporting requirements / International Technical Standards (ITS).**

Subordination Changes

- Under **BRRDI, RA's had the option to require MREL subordination** on a case-by-case basis (not included in BRRDI implementation in Gibraltar).
- The **Banking Package mandates partial MREL subordination** for different categories of banks; it sets a minimum amount for these subordinated liabilities (i.e. those ranking below traditional senior debt).
- In addition to G-SII's or Top Tier Banks, this **subordination requirement also applies to where a firm has been assessed as being reasonably likely to pose a systemic risk in the event of failure***.

***Note:** *Subordination requirements can also be required where there are risks of no creditor worse off claims.*

Other material BRRDII Changes

1. Moratorium tool provided to Resolution Authorities

Where a firm is failing or likely to fail, BRRDII provides a new moratorium power to RA's. This power to suspend delivery and payment obligations includes covered deposits for a maximum of 2 days.

2. Contractual recognition of stay powers

BRRDII introduces a requirement for firms to include a contractual term within financial contracts governed by 3rd country law, recognising that the contract may be subject to suspend or restrict obligations (by the RA).

3. Contractual recognition of bail-in clause

BRRDII provides an exemption for firms, where impractical to introduce contractual terms for bail-inable liabilities from 3rd Countries.

HMT Consultation (BRRDII)

- On 23rd June, **HMT launched a consultation** on its proposed approach to BRRDII implementation.
- This proposal **generally aligns to that of BRRDII** (except for the certain revisions of the MREL framework).
- The UK's current MREL framework aligns to the Financial Stability Board's international standards and as such 'gold-plated' the transposition of BRRDI. With that in mind, **certain technical areas of the BRRDII are proposed not be transposed into UK legislation** (as, in principal it is already included).
- The consultation will run until 11 August 2020, with the **outcome not likely to be published before Q4 2020.**
- The RCU move to **transitional MREL deadlines (final implementation 2024)** will also provide much-needed headroom in this regard.

Next Steps

- Gibraltar **Impact Analysis Continues** (re BRRDII and UK Consultation).
- **Monitoring of HMT Consultation** and subsequent UK Policy adoption re MREL.
- Industry participants are encouraged to **discuss/provide feedback to the RCU** over the coming months.
- **Policy decision on BRRDII application** (on the back of UK implementation) to be made. Ultimately this will be a decision for Government of Gibraltar.
- Policy **Briefing on BRRDII adoption** to be provided to industry participants.
- **MREL Workshops** to cover the following (and any other required):
    - MREL calibration.
    - Criteria for MREL eligible liabilities.
    - Future Reporting.
- **Rolling Q&A** to be made available to industry participants.

Summary

- BRRDII is required to be implemented by December 2020 as part of the Banking Package.
- A series of targeted amendments to existing legislation are to be implemented to further reduce risk in the banking sector.
- It is, however, proposed that a number of MREL revisions will not be implemented in the UK as part of BRRDII, given that the current standards align to that of the FSB.
- The proposed UK implementation will continue to be monitored.
- CRDV Working Group and industry participant to be kept aware final implementation policy.

Questions

Comments