MREL Policy

RCU Guidance Note

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Financial Services Resolution & Compensation Committee

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1. Introduction

1.1 The Gibraltar Financial Services Commission ("GFSC") is the appointed Resolution Authority ("RA") for Gibraltar. The powers of the GFSC as RA are delegated to the Financial Services Resolution and Compensation Committee ('FSRCC'), which was established in 2016. The FSRCC is responsible for resolution planning for Credit Institutions as well as decision-making relating to the reorganisation of institutions experiencing financial difficulties. This is in line with the Financial Services Act 2019 ('the Act') and international global standards.

1.2 The Minimum Requirement for Own Funds and Eligible Liabilities ("MREL") is a key regulatory requirement that aims to ensure that banks have sufficient resources to absorb losses and maintain their critical functions in the event of a crisis. MREL was introduced in response to the global financial crisis of 2008, which highlighted the need for banks to hold enough loss-absorbing capital to avoid taxpayer bailouts in times of stress.

1.3 In response, global regulators, including the Financial Stability Board and the Basel Committee on Banking Supervision, developed a framework for Total Loss-Absorbing Capacity ("TLAC"), which sets out the minimum amount of loss-absorbing resources that globally systemic banks should hold. Building on the TLAC framework, the EU introduced MREL requirements as part of its Bank Recovery and Resolution Directive ("BRRD"), which was adopted in 2014 in response to the crisis. The BRRD requires banks to maintain a minimum level of MREL to ensure that they can be resolved in an orderly manner without causing wider financial instability.

1.4 The adoption of MREL requirements has been phased in gradually since 2016, with banks required to meet the minimum MREL level by 2024. Under MREL, banks are required to hold a minimum amount of own funds and eligible liabilities that can be used to absorb losses and recapitalize the bank in the event of a crisis. This means that shareholders, creditors, and investors would bear the losses rather than taxpayers. In essence, MREL is intended to ensure that banks have sufficient resources to continue operating and avoid insolvency or bankruptcy.

Purpose of this document

1.5 This RCU Guidance Note ("MREL Policy") sets out transparently the mechanism for calibrating MREL used by the FSRCC for the purpose of increasing legal certainty in Gibraltar. Whilst international best practices and standards are used as the main guidance for the resolution authority, the disclosure is restricted to relevant scenarios within Gibraltar to minimize complexity. As a result, there are no additional statements regarding G-SIBs, top tier banks, cooperative banks or building societies.

1.6 The aim this document is to empower affected entities to independently calculate their expected MREL and efficiently integrate it into their overall bank management. Additionally, this documentation serves as a disclosure to other financial market participants and stakeholders. In specific cases, where necessary and in compliance with its statutory and legal competences, the FSRCC may deviate from the guidelines outlined in this MREL Policy.

2. Background

MREL at a global level

2.1 MREL is a critical component of the resolution framework established by the EU's BRRD. Following the UK's exit from the EU, the UK government also introduced a UK BRRD equivalent as part of domestic law, that aims to maintain financial stability and protect taxpayers in the event of bank failures. Both the EU & UK BRRD set out a comprehensive framework for resolving banks in distress, and MREL is a key tool for ensuring that the framework is effective. By requiring banks to hold a minimum amount of loss-absorbing capital, MREL enables resolution authorities to take action to resolve a bank in a way that protects financial stability and minimizes the impact on taxpayers.

2.2 Across the EU & UK, MREL is set on a case-by-case basis, considering the specific circumstances of each bank. The level of MREL required for each bank is determined by the resolution authority, based on factors such as the size and complexity of the bank, the risks it faces, and its business model. The MREL requirement is reviewed regularly to ensure that it remains appropriate and effective.

MREL in Gibraltar

2.3 The journey towards MREL implementation in Gibraltar began with an industry workshop in February 2018, where discussions focused on the impact of MREL on the industry. A formal notification was given in July 2018 that Gibraltar would be subject to MREL requirements, with full-state MREL being notified as a binding requirement.

2.4 In response to the COVID-19 pandemic, relief measures were introduced in June 2020 to aid banks in meeting their MREL requirements. The BRRD2 was transposed into Gibraltar legislation in December 2020, providing a framework for firms to meet MREL and bank recovery and resolution. Interim MREL targets were communicated to banks in 2021, with quarterly data reporting beginning in May 2022 to meet the final binding targets by January 2024.

2.5 Overall, the journey to MREL in Gibraltar has been in close collaboration with industry and involved a series of steps to ensure that banks operating in Gibraltar are prepared to meet the requirements of this important regulatory framework. The transposition of BRRD2 into Gibraltar legislation, the introduction of relief measures following the COVID-19 pandemic and the phased target approach have demonstrated the commitment from both regulators and banks to ensuring the stability of the financial system in Gibraltar.

3. Definitions

Term	Definition
Resolution Entity	(a) a legal person established in Gibraltar, which, in accordance with Regulation 12 of the Financial Services Recovery and Resolution Regulations 2020, is identified by the resolution authority as an entity in respect of which the resolution plan provides for resolution action, or; (b) an institution that is not part of a group that is subject to consolidated supervision, in respect of which the resolution plan drawn up under Regulation 10 provides for resolution action.
Resolution Group	A resolution entity and its subsidiaries that are not; (i) Resolution entities themselves; (ii) Subsidiaries of other resolution entities; or (iii) Entities established in a third country that are not included in the resolution group in accordance with the resolution plan and their subsidiaries.
Minimum Requirement for Own Funds and Eligible Liabilities ("MREL")	Set by resolution authorities to ensure that a bank maintains at all times sufficient eligible instruments to facilitate the implementation of the preferred resolution strategy.
Loss Absorption Amount ("LAA")	Loss Absorption Amount: Amount of capital resources the Central Bank deems necessary for an institution to absorb losses in resolution.
Recapitalisation Amount ("RCA")	Amount of capital resources the Central Bank deems necessary for an institution, or its successor entity, to meet its authorisation requirements in relation to its activities, or parts thereof, following the application of resolution tools
Pillar 1 Capital Requirements ("P1")	Minimum own funds requirement of the institution as calculated under the Capital Requirements Regulations.
Pillar 2 Capital Requirements ("P2")	Additional own funds requirement of the institution set by the competent authority, for example to reflect additional risks, or additional elements of risks, not covered by the P1 requirement.
Leverage Ratio Exposure ("LRE")	The exposure measure for the leverage ratio will be the sum of (a) on-balance sheet exposures; (b) derivative exposures; (c) SFTs exposures; and (d) OBS items. On-balance sheet, non-derivative exposures should be included net of specific provisions or accounting valuation adjustments.
Risk Weighted Assets ("RWA")	Used to determine the minimum amount of capital a bank must hold in relation to the risk profile of its lending activities and other assets.
Subordinated Eligible Instruments	Instruments that fulfil the conditions laid down by Article 72a of the CRR.
Bail-In	A bail-in is a form of financial relief for an institution that is at risk of failure. It does this by making it so that any debt that is owed to depositors and creditors is cancelled.

4. Framework for setting MREL

4.1 The Financial Services (Recovery and Resolution) Regulations 2020, specifically Regulation 45, sets out the framework for the calibration of MREL, including its application and calculation. The FSRCC, in conjunction with the GFSC, have set MREL in accordance with this framework. In order to set the minimum threshold, MREL uses capital requirements (i.e. Pillar 2, Pillar 2A and capital buffer requirements and any applicable leverage ratio requirement) as reference points.

4.2 Given the size and nature of the jurisdiction, the FSRCC have agreed to calculate MREL as a harmonised minimum level that is consistent across all banks in Gibraltar. This baseline calculation for institutions is based on the sum of two components: a loss absorption amount and a recapitalisation amount.

Loss absorption amount ("LAA")

4.3 The loss absorption amount is used to cover the losses that would need to be absorbed up to in a resolution. Typically, the loss absorption amount will equal an institution's capital requirements (Pillar 1 plus Pillar 2A or, if applicable and higher, the institution's leverage ratio requirement). The FSRCC have agreed to set the LAA to the higher of 10.5% risk-weighted assets or 3% leverage exposure. The aim of this approach is to make MREL straightforward and consistent across the jurisdiction.

4.4 The FSRCC have the discretion to add (or remove) capital buffers from the loss absorption amount if they are deemed to be relevant (or not relevant) to absorbing losses in resolution and involving stabilisation powers. The FSRCC considers information received from the GFSC, as the competent authority, relating to an institution's business model, funding model and risk profile.

4.5 In light of the interaction of MREL and capital buffers, in particular that CET1 cannot be used simultaneously to meet both MREL and capital buffers, the FSRCC have excluded buffers from the loss absorption amount for institutions subject to this policy. This includes those entities with a modified insolvency resolution strategy, including those for which the GFSC is the competent authority. As a result, the FSRCC have aimed to set the loss absorption amount in line with an institution's regulatory capital requirements.

Recapitalisation amount ("RCA")

4.6 The FSRCC will set the recapitalisation amount ranging from 0% to 100% of the LAA, depending on the firm's resolution strategy. The RCA may be adjusted by the FSRCC, subject to consultation with the GFSC and certain statutory conditions on a resolution entity specific basis. Such adjustments may result in a higher or lower RCA, depending on the resolution strategy for the resolution entity.

Example MREL Calibration

4.7 MREL is calibrated based on the following equation:

MREL = loss-absorption amount ("LAA") + recapitalisation amount ("RCA").

Where:

LAA = a firm's minimum capital requirement (e.g. the higher of: the sum of Pillar 1 + 2A risk-weighted capital requirements or leverage requirement).

RCA = the range between 0% to 100% of the LAA, depending on a firm's prescribed resolution strategy (0% in the case of insolvency and 100% for those with a bail-in or transfer resolution strategy).

End-State Target

4.8 The FSRCC expects resolution entities in respect of which bail-in is the preferred resolution strategy to comply with the following end-state MREL target, as applicable. **As from January 2024, such resolution entities must at all times satisfy a statutory MREL at least equivalent to the higher of:**

a) 21% of Risk Weighted Assets (“RWA”) or;

b) 6% of Leverage Ratio Exposure (“LRE”).

Methodology

4.9 Basel III, via the Capital Requirements Directive (“CRD”), established an 8% minimum Pillar 1 capital requirement, in addition to a supplementary Pillar 2 firm specific capital requirement held for a firm’s individual credit, market and operational risk. It is recognised that Pillar 2 capital requirements can fluctuate and depend largely on a firm’s situation.

4.10 The FSRCC is proposing, for the purposes of MREL only, to set this Pillar 2A requirement to 2.5% for all firms (i.e. a combined P1+P2A capital requirement of 10.5%). In the EU, the Basel standards require banks to maintain a Tier 1 leverage ratio of at least 3%. In the EU, this minimum became binding with the introduction of the revised Capital Requirements Regulation in 2021.

4.11 As a result, for those entities with a resolution strategy of bail-in, the RCU has set the LAA to 10.5% of capital requirements (i.e. Pillar 1 (8%) + Pillar 2A (2.5% for all firms)) or 3% of LRE (minimum leverage requirement), with the RCA set to 100%.

5. Resolution Strategies and MREL

5.1 This section outlines key factors the FSRCC will consider when determining the preferred resolution strategy, and how this determination may affect any MREL that is set for an institution. It is important to note that the actual approach taken to resolve an institution will depend on the circumstances at the time of its failure. The preferred resolution strategy may not necessarily be followed if a different approach would better meet the resolution objectives at the time.

Modified Insolvency

5.2 For those institutions that would be wound up in an orderly manner under normal insolvency proceedings, rather than subject to resolution tools if they failed, the FSRCC may limit or set in excess the default LAA as referred to in Section 4. The FSRCC will consider this with particular reference to any possible impact on financial stability and on the risk of contagion to the financial system. Indicative examples of this include:

- Where the failure of an institution could have a material impact on the Gibraltar Deposit Guarantee Scheme ("DGS") and/or the Gibraltar Investor Compensation Scheme ("ICS") and/or on the DGS/ICS contribution requirements of institutions.
- Where the failure of an institution could, notwithstanding limited domestic impact, have a material impact on a cross-border basis.
- Where the failure of an institution, given its business model and profile, could reasonably be considered to risk triggering or amplifying contagion in the financial system. For institutions that would be wound up in an orderly manner under normal insolvency proceedings if they failed, MREL will be determined on an individual basis only.

Transfer Strategies

5.3 Where a resolution entity would be subject to a transfer resolution strategy (i.e. where use of the sale of business, bridge institution and/or asset separation tool would be assumed either on a standalone basis or in addition to another resolution action), the FSRCC may choose to apply a downward scaling factor at a level deemed appropriate. This scaling factor is intended to reflect the recapitalisation needs post-resolution, or the level of assets that would be transferred and/or liquidated under normal insolvency proceedings and is applied to the total assets of the resolution entity in order to act as a proxy for such needs.

5.4 Depending on resolution entity-specific criteria, the scaling factor may be applied, for example, where the resolution strategy envisages that the majority of the resolution entity's balance sheet post-resolution will be transferred to a buyer, with the remaining non-viable section being liquidated. As a result, the post-resolution resolution entity will require a lesser degree of recapitalisation compared to the original resolution entity before any resolution action is taken.

Bail-in

5.5 The stabilisation power that is most likely to be appropriate for banks in Gibraltar, given their size in proportion to the economy, is bail-in. The FSRCC's assessment will depend on each institution's business model, scale and complexity. The FSRCC expects Gibraltar resolution entities subject to a bail-in strategy to ensure that their MREL resources are subordinated to operating liabilities, using structural subordination. Subordination of MREL resources reduces the risk of breaches of the No Creditor Worse Off ("NCWO") principle that safeguards in the event of a bail-in. Further detail to be provided under the NCWO and subordination requirements section.

5.6 The FSRCC expects to direct resolution entities in respect of which bail-in is the preferred resolution strategy to comply with the end-state MREL target.

NCWO risk and subordination requirements

5.7 The NCWO risk refers to the risk that, as a result of the planned usage of write-down and conversion powers for non-subordinated liabilities that are not excluded from the application of resolution powers, creditors owed claims pertaining to these liabilities may have to bear greater losses than they would in the event of liquidation (according to ordinary insolvency procedures). The requirement to ensure that no creditors are worse off is one of the general principles governing resolution, as per Regulation 34(1)(g) of the Financial Services Recovery and Resolution Regulations 2020.

5.8 The assessment of the NCWO risk and the setting of a subordination requirement is thus of central importance for the resolvability of an entity. The purpose of subordination is to reduce the NCWO risk. However, if the entity's resolution plan envisages liquidation or modified insolvency as the preferred strategy, then subordination is never required.

5.9 Pursuant to Regulation 45B(12) of the Financial Services Recovery and Resolution Regulations 2020, the resolution authority is allowed to require the entity to ensure that a particular portion of MREL is made up of own funds and Subordinated Eligible Instruments. Subordinated eligible instruments means instruments that meet all the conditions referred to in Article 72a of the Capital Requirements Regulation other than paragraphs (3) to (5) of Article 72b of that Regulation.

6. Eligibility Criteria

6.1 In order for MREL resources to fulfil their intended purpose, it must be practically straightforward for the FSRCC to apply its stabilisation powers to them, including the bail-in stabilisation power. The Financial Services Recovery and Resolution Regulations 2020, via Articles 72(a),(b) & (c) of the Capital Requirements Regulation, sets out a number of requirements that liabilities must meet in order to qualify as MREL eligible liabilities.

6.2 One of these is that the liability must have an effective remaining maturity (taking account of any rights for early repayment available to the investor) of greater than one year. Likewise, an institution should not call or redeem an MREL eligible liability if that would cause it to breach its MREL, or if the institution is already in breach of its MREL, unless the FSRCC or GFSC approves such a transaction.

6.3 Liabilities which value is dependent on derivatives are not to be appropriate to qualify as MREL eligible. Additionally, liabilities which include only put or call options to be dependent on derivatives are not considered eligible for this purpose. Liabilities subject to contractual set-off or netting arrangements are not appropriate MREL eligible liabilities.

6.4 Where a liability is governed by non-Gibraltar/UK law, institutions will need to ensure that the liability could also absorb losses and contribute to recapitalisation costs in resolution, having regard to the terms of the contract and legal opinions, in line with the EU BRRD and contractual recognition of bail-in rules.

6.5 In summary, the following eligibility criteria for equity and debt instruments to qualify as MREL:

- Issued and fully paid up;
- Not owed to, secured by or guaranteed by a firm itself;
- Not funded directly or indirectly by a firm;
- Remaining eligible maturity of at least one year;
- Not a derivative liability;
- Not a preferred deposit;
- Instrument that creates liability is not governed by a third country (i.e. outside of Gib/UK).

6.6 The responsibility for ensuring that liabilities, including own funds instruments, are eligible as MREL rests with institutions. Institutions should obtain independent legal advice on a liability's eligibility, and provide this to the FSRCC, where required.

7. MREL Reporting and Supervision

7.1 As per Regulation 45I(1) of the Financial Services Recovery and Resolution 2020 Regulations, entities must report the amounts of own funds and the amounts of eligible liabilities that meet the MREL criteria, including their composition, e.g. their maturity profile and their ranking in normal insolvency proceedings, where applicable.

7.2 In 2021, the FSRCC proposed that the MREL Resources Forecast ("MRL001" & "MRL002") template would be submitted via Invoke on the same frequency, reporting date and submission due date as firms' Capital+ submissions. This has allowed the FSRCC to gain an understanding on how firms are faring during the interim target phases. As a reminder, firms have been reporting on their eligible MREL resources since Q1 2022 via the Invoke data portal. Please see the interim and final target levels below:

- January 2022: 15.5% of Risk Weighted Assets ("RWA") or 5% of Leverage Ratio Exposure ("LRE").
- January 2023: 18% of RWA or 6% of LRE.
- January 2024: 21% of RWA or 6% of LRE.

7.3 After consulting with the GFSC and reviewing international best practices, the FSRCC has decided to maintain a quarterly reporting frequency for the MRL002 template, which tracks the forecasted amount of MREL resources.

8. MREL Breaches

8.1 Firms are expected to meet MREL at all times and the FSRCC, in conjunction with the GFSC, must address any breaches of MREL. As per the Financial Services Recovery and Resolution 2020 Regulations, specifically Regulation 17, the FSRCC must notify the GFSC of any impediments to resolvability.

8.2 Within two weeks of the date of receipt of a notification, the entity must propose a timeline for their implementation plan to ensure that the entity complies with its MREL requirements. The firm must, within four months of receipt of a notification propose possible measures to address an MREL deficit.

8.3 Further measures may be taken by the FSRCC if the proposals by an entity do not effectively reduce or remove an MREL breach or an impediment to resolution, including:

- require the entity to revise any intragroup financing agreements or review their absence, or draw up service agreements, whether intra-group or with third parties, to cover the provision of critical functions;
- require the entity to limit its maximum individual and aggregate exposures;
- impose specific or regular additional information requirements relevant for resolution purposes; require the entity to divest specific assets;
- require the entity to limit or cease specific existing or proposed activities;
- restrict or prevent the development of new or existing business lines or sale of new or existing products;
- require changes to legal or operational structures of the entity or any group entity, either directly or indirectly under its control, so as to reduce complexity in order to ensure that critical functions may be legally and operationally separated from other functions through the application of the resolution tools;
- require an institution to renegotiate any eligible liability, including additional Tier 1 instrument or Tier 2 instrument it has issued.
- Require a change to the maturity profile of own funds instruments (following agreement from GFSC) and other eligible instruments.