



THE NEW REGULATORY FRAMEWORK ON THE MREL - IMPLEMENTATION IN ITALY OF DIRECTIVE (EU) 2019/879 (BRRD II)

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1. *The implementation of BRRD II in Italy*

On 30 November 2021, Italian Legislative Decree no. 193 of 5 November 2021 was published on the Official Gazette (“**Legislative Decree 193/2021**” or the “**Decree**”) for the purposes of implementing in Italy Directive (EU) 2019/879 (“**BRRD II**”). BRRD II amends Directive 2014/59/EU (“**BRRD**”) as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC. The Decree also aims at adapting domestic legislation to Regulation (EU) no. 806/2014, as amended by Regulation (EU) 2019/877, (“**SRMR**”) that established a uniform set of rules and procedures for the resolution of credit institutions and certain investment firms under the Single Resolution Mechanism and the Single Resolution Fund and amended Regulation (EU) no 1093/2010.

The Decree, *inter alia*, amends certain provisions on the Minimum Requirement for own funds and Eligible Liabilities (“**MREL**”) set out in Italian Legislative Decree no. 180 of 16 November 2015, which implemented the BRRD in Italy as it includes domestic rules on the recovery and resolution of credit institutions and investment firms (“**Legislative Decree 180/2015**”), by introducing a new Chapter II *bis*.

The amendments introduced at European level by BRRD II are first of all aimed at ensuring harmonisation between the MREL requirement introduced by the BRRD and the standard on Total Loss-Absorbing Capacity (“**TLAC**”) agreed at

international level by the Financial Stability Board and consisting of the obligation for Global Systemically Important Banks (“G-SIBs”) and Global Systemically Important Institutions (“G-SIIs”) to hold a sufficient amount of highly loss-absorbing liabilities in order to ensure that minimum levels of regulatory capital can be restored in the event of resolution of the G-SIBs and G-SIIs.

The implementing provisions on MREL under the Decree provide for this requirement to be complied with as from 1 January 2024; in order to ensure compliance with the requirement within the prescribed timeframe, the provisions entitle the Bank of Italy to set intermediate requirements to be complied with as from 1 January 2022, which serve to ensure an increase in own funds and eligible liabilities, on the understanding that the Bank of Italy may postpone the final term set for 2024 on a case-by-case basis.

The Decree is without prejudice to the determinations of the MREL requirement adopted prior to the date of entry into force of the Decree until the adoption of new determinations of the MREL requirement pursuant to the new provisions of Chapter II *bis*, of Legislative Decree 180/2015.

2. *The MREL regulatory framework*

2.1 The MREL requirement

The new MREL requirement set out in Article 16-*bis* of Legislative Decree 180/2015 consists of two ratios calculated as the amount of own funds and eligible liabilities, that is expressed as a percentage of:

- the total risk exposure amount (“**TREA**”) referred to in Article 92 of Regulation (EU) 575/2013, as amended *inter alia* by Regulation (EU) 2019/876 (“**CRR**”);
- the leverage ratio exposure measure (“**LREM**”) as defined in Article 429 of the CRR in relation to the calculation of leverage ratio.

A new element introduced at European level with the BRRD II is that non- resolution entities (*i.e.*, an entity for which the group resolution plan does not provide for a resolution action) are also subject to the MREL requirement, as specified below.

In this respect, a distinction is made between:

- internal MREL, namely, the requirement applied at the individual level to the non-resolution entity; and
- external MREL, which applies to the resolution entity on a consolidated basis at the level of the group under resolution.

The legislation also provides for an exemption from the obligation to comply with the MREL requirement for intermediaries enrolled in the register referred to in Article 106 of Italian Legislative Decree no. 385 of 1 September 1993 (*Testo Unico Bancario* – “**TUB**”) which finance themselves with secured bonds and grant financing only in the form of secured loan, if the conditions set out in Article 16-*ter* of Italian Legislative Decree no. 180/2015 are met.

2.2 Determination of the MREL requirement for resolution entities

In line with the pre-Decree legal framework, the MREL requirement is determined on a case-by-case basis by the Resolution Authority.

The regulation establishes the criteria for the determination of MREL, providing in this regard that – in the event of adopting a resolution action or exercising the power to write down or convert capital instruments and eligible liabilities – the MREL requirement must be such so as to ensure that (i) the losses that are expected to be incurred by the resolution entity, and (ii) the recapitalisation of such entity and of the subsidiaries belonging to the group under resolution to a level that ensures that the requirements of applicable regulations are met.

The MREL requirement therefore consists of two elements:

- (a) the loss absorption amount under the resolution, which will be equal to:
 - (i) when calculated as a percentage of the TREA, Pillars 1 and 2 capital requirements at the consolidated resolution group level; or
 - (ii) when calculated as a percentage of LREM, the leverage ratio at the consolidated resolution group level;
- (b) the recapitalization amount aimed at reconstituting:
 - (i) when calculated as a percentage of the TREA, the total capital ratio and the binding Pillar 2 capital requirement at the consolidated resolution group level; or
 - (ii) where it is expressed as the LREM, the leverage ratio at the consolidated resolution group level.

The Bank of Italy may also increase the amount of the recapitalization with an additional market confidence buffer.

Regarding the measure of the MREL requirement, the current regulatory framework sets a minimum threshold only with reference to:

- (i) resolution entities that are G-SIIs or material subsidiaries of non-EU G-SIIs (as well as for material subsidiaries included in the scope of prudential consolidation of a non-European entity that qualifies as a G-SII), for which, by referring to the TLAC framework contained in the CRR, it is established that the MREL consists of the sum of:
 - (a) the requirements of Articles 92-bis (*i.e.*, 18% of the TREA) and 494 (*i.e.*, and 6.75% of the LREM) of the CRR (Pillar 1 requirements); and
 - (b) where the MREL calculated in this way is not sufficient to ensure compliance with the conditions established by the regulations for resolution entities (Article 16-quinquies of Legislative Decree no. 180/2015), an additional requirement (Pillar 2 requirement) is imposed by the Bank of Italy;
- (ii) larger entities - *i.e.*, entities that are not G-SIIs and that are part of a group under resolution whose total assets exceed € 100 billion – for which the MREL requirement is set at least equal to either (a) 13.5% of the TREA; or (b) 5% of the LREM.

2.3 Eligible liabilities in MREL

With respect to the previous regulations, the new MREL framework regulates the eligibility criteria for liabilities for the inclusion in the MREL by substantially referring to the requirements set out in the CRR.

In particular, liabilities that meet the conditions set out in Articles 72 bis of the CRR (*Eligible Liability Items*), 72-ter CRR (*Eligible Liability Instruments*), and 72-quater of the CRR (*Amortisation of Eligible Liability Instruments*) are eligible for inclusion in the MREL requirement. However, it is provided that for resolution entities that are G-SIIs or are part of a G-SII or in

relation to material subsidiaries of non-EU G-SIIs that are not resolution entities, the liabilities specified in Article 72-*duodecies* of the CRR are eligible.

Conversely, the subordination requirement of Article 72-*ter*, paragraph 2d) of the CRR is excluded from the above criteria. However, by way of exception to the above:

- the subordination requirement must be met for resolution entities that are G-SIIs or are part of a G-SII or in relation to material subsidiaries of non-EU G-SIIs that are not resolution entities;
- with respect to resolution entities that are G-SIIs, larger entities or entities assimilated to a larger entity, a component of the MREL requirement equal to 8% of total liabilities (Pillar 1 subordination requirement), or a lower percentage if the liabilities meet all the requirements of Article 72-*ter*, paragraph 3, of the CRR, must be satisfied by own funds, eligible subordinated instruments or liabilities referred to in paragraph 4 of Article 16-*quater* of Legislative Decree 180/2015. The Bank of Italy may establish a higher amount calculated according to the mathematical formula set out in paragraph 11 of Article 16-*quater* of Legislative Decree 180/2015 (the so-called Pillar 2 subordination requirement) for a maximum number of resolution entities that are G-SIIs, larger entities or entities assimilated to the latter that is equal to 30% of the total number of such entities.

In relation to non-G-SIIs entities, larger entities or entities assimilated to a larger entity, the Bank of Italy may provide that a component of the MREL requirement is met using own funds, subordinated instruments and liabilities referred to in Article 16-*quater*, paragraph 4, of Legislative Decree 180/2015 if the following conditions are met:

- a) non-subordinated eligible liabilities that have the same ranking in the bankruptcy hierarchy as liabilities that are excluded or reasonably likely to be excluded from the application of the bail-in;
- b) there is a risk that, as a result of the application of the write off and conversion powers to non-subordinated liabilities that are not excluded or not reasonably likely to be excluded from the application of the bail-in, the holders of receivables arising from such liabilities will incur greater losses than they would incur in a compulsory administrative liquidation (*liquidazione coatta amministrativa*) or other similar applicable insolvency procedure;
- c) the amount of own funds and other subordinated liabilities does not exceed what is necessary in order to prevent the creditors referred to in point b) from incurring losses greater than those which they would incur in a compulsory administrative liquidation or similar applicable insolvency procedure.

Further eligibility criteria are established with reference to debt securities incorporating a derivative component, in respect of which it is provided that they are included in the MREL requirement, by way of exception to Article 72-*bis*, paragraph 2 (l) of the CRR, if they meet at least one of the conditions set out in Article 16-*quater*, paragraph 2, of Legislative Decree 180/2015.

The Bank of Italy, pursuant to Article 16-*septies* of Legislative Decree 180/2015, determines the MREL requirement applicable to resolution entities at the consolidated resolution group level, in accordance with the framework described in Articles 16-*quater*, 16-*quinquies* and 16-*sexies* of Legislative Decree 180/2015, also taking into account that subsidiaries based in third-party countries may be subject to separate resolution proceedings.

2.4 Application of MREL requirement for non-resolution entities

The MREL requirement also applies to banks that are subsidiaries of a resolution entity (including banks located in a third-party country) that are not themselves resolution entities and are required to apply the MREL on an individual basis (the so-called internal MREL).

The MREL requirement for entities other than resolution entities consists of the following elements:

- (a) the loss absorption amount, which will be equal to:
 - (i) when calculated as a percentage of the TREA, Pillars 1 and 2 capital requirements at individual level; or
 - (ii) when calculated as a percentage of the LREM, equal to the leverage ratio at individual level;
- (b) the recapitalization amount aimed at reconstituting:
 - (i) when calculated as a percentage of the TREA, the total capital ratio and the binding Pillar 2 capital requirement at individual level; or
 - (ii) when it is expressed as the LREM, the leverage ratio at individual level.

The MREL requirement is met by using (Article 16-octies of Legislative Decree 180/2015):

- (a) liabilities not eligible for own funds that comply with the following requirements:
 - (i) they are purchased or subscribed by the resolution entity, whether directly or indirectly through other entities belonging to the same group under resolution, or they are purchased or subscribed by a shareholder that is not part of the same resolution group, provided that the exercise of the write-down or conversion powers does not affect the control of the issuer by the resolution entity;
 - (ii) they fulfil the eligibility criteria set out in Article 72-bis of the CRR, with the exception of Article 72-bis, paragraphs 2 (b), (c), (k), (l) and (m) and Article 72-bis, paragraphs 3, 4 and 5 of the CRR;
 - (iii) in the event of compulsory administrative liquidation or other assimilated insolvency proceedings applicable, they rank lower than liabilities which do not comply with the condition under point (i) and which are not eligible for inclusion in own funds;
 - (iv) they may be subject to write-down or conversion in a manner consistent with the chosen strategy for the group under resolution, without affecting, in particular, the control of the issuer by the resolution entity;
 - (v) the acquisition or subscription is not funded directly or indirectly by the issuer;
 - (vi) the law or the contract does not provide, even implicitly, that the liabilities would be called, redeemed, repaid or repurchased, except in the case of insolvency or liquidation of the issuer and the issuer does not otherwise provide such an indication;
 - (vii) the law or the contract does not give the holder the right to accelerate the future scheduled payment of interest or principal, except in the case of the insolvency or liquidation of the issuer;
 - (viii) the level of interest or dividend payments is not amended on the basis of the credit standing of the issuer or its parent undertaking;
- (b) the following own funds items or instruments:
 - (i) Common Equity Tier 1 capital;

- (ii) other own funds items or instruments that are bought or subscribed by entities belonging to the resolution group or by other entities, provided that the exercise of the write down or conversion powers does not affect the control of the issuer by the resolution entity.

This is without prejudice to the Bank of Italy's option not to apply the MREL requirement provided that certain conditions are met.

In addition, it is provided that where (a) the resolution entity and its subsidiary have their registered offices in Italy and belong to the same resolution group and (b) the resolution entity meets the requirement on a consolidated basis pursuant to Article 16-*septies* of Legislative Decree 180/2015, the Bank of Italy may allow the MREL requirement to be met, in whole or in part, by means of a guarantee provided by the resolution entity that complies with all the conditions set out in this provision (e.g. the guarantee is provided for an amount which is, at least, equivalent to the amount of the requirement for which it substitutes; the guarantee is collateralised through a financial collateral arrangement for at least 50% of its amount).

2.5 Breach of the MREL requirement

In the event of a breach of the MREL requirement, without prejudice to the powers of the ECB when it is the competent authority, the Bank of Italy shall adopt, to the extent of its competence, one or more of the following measures:

- (a) the removal of impediments to resolvability pursuant to Articles 14, 15 and 16 of Legislative Decree 180/2015;
- (b) the prohibition to make distributions pursuant to Article 13-*bis* of Legislative Decree 180/2015;
- (c) the measures referred to in Articles 53-*bis* and 67-*ter* of the TUB;
- (d) the early intervention measures in accordance with Title IV, Chapter I, Section 01-I of the TUB;
- (e) the sanctions and other measures provided for in Title VII of Legislative Decree 180/2015.

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