MFSA MALTA FINANCIAL SERVICES AUTHORITY

Circular

23 February 2021

Amendments introduced by the Bank Recovery and Resolution Directive II

Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalization capacity of credit institutions and investment firms and Directive 98/26/EC (the BRRD2) aims at further harmonising the European Union's resolution policy. The BRRD2 has been transposed into national legislation by means of Legal Notice 6 of 2021. The amendments introduced by the BRRD2 include the partial harmonisation of the triggers of normal insolvency proceedings, new categories for credit institutions, changes to the calibration, subordination and eligibility requirements in relation to the minimum requirement of own funds and eligible liabilities (MREL), introduces new reporting and disclosure requirements for MREL, provides clarification on the implications of a breach of MREL, grants added protection to retail investors, integrates the total loss-absorbing capacity (TLAC) for Global Systemically Important Institutions (G-SIIs) into MREL calibration and clarifies the application of single point of entry and multiple point of entry strategies. Details on some of the abovementioned amendments are provided hereunder.

With the introduction of the new Article 32b, the BRRD2 requires Member States to ensure a bank's orderly exit from the market. In this regard, institutions or entities which are determined as failing or likely to fail, the failure of which cannot be prevented by alternative private sector measures, are to be wound up in an orderly manner, in the event that resolution of such institutions or entities would not be in the public interest.

The BRRD2 requires Member States to ensure that entities and institutions have sufficient loss-absorbing and recapitalisation capacity to ensure a smooth and fast absorption of losses and recapitalisation with minimum impact on taxpayers. For the purposes of aligning MREL to the TLAC standard, the new amendments require MREL to be expressed as a percentage of the total risk exposure amount and of the total exposure measure. The BRRD2 has aligned the eligibility criteria for bail-inable liabilities for MREL with the TLAC minimum requirements set in Regulation (EU) No 575/2013 (CRR). Changes to the component of the newly defined "eligible liabilities" also contributes to enhance the quality of these debt instruments with the expectation that such are highly loss-absorbing and easy to bail-in in resolution. According to the BRRD2, all liabilities resulting from claims arising from ordinary unsecured creditors (non-subordinated liabilities) may be used to meet MREL requirements. Apart from allowing the possibility to meet part of its MREL requirements with own

funds, National Resolution Authorities (NRAs) are now able to require entities and institutions to meet their MREL through other subordinated liabilities. This promotes more efficient use of the bail-in tool particularly where there is a clear indication that bailed-in creditors will likely bear losses in resolution which would exceed the losses that would have been incurred had the entity or institution been wound up under normal insolvency proceedings. The BRRD2 further provides that, in relation to consolidated MREL at resolution group level, institutions or entities identified as resolution entities in terms of the CRR, are required to meet their MREL on a consolidated basis and must therefore issue eligible instruments and items to third-party creditors external to the resolution group. Such would be bailed-in if the resolution entity enters resolution. However, institutions and entities that are not themselves resolution entities are to meet their MREL at an individual level. This is such since, the loss absorption and recapitalisation requirements of such entities or institutions should be generally covered by their respective resolution entities, through a direct or indirect acquisition by that resolution entity through own funds instruments and eligible liabilities instruments issued by those institutions or entities. Moreover, breaches of the binding MREL and TLAC have also been clarified through a number of amendments introduced along with reporting and disclosure obligations, with the scope of promoting transparency on the application of MREL to Competent and Resolution Authorities and to the public.

In order to limit access and dependence on retail investors, the BRRD2 has introduced a new Article 44a so as to offer a level of protection to such investors by obliging the seller of subordinated eligible liabilities to subject retail clients to the suitability test in terms of Directive 2014/65/EU ("MiFID"). This obligation applies to retail clients purchasing subordinated eligible liabilities issued after 28th December 2020 (the transposition date of the BRRD2). Lastly, NRAs have the power to suspend certain contractual obligations of entities and institutions, which power is deemed necessary and useful. The power to suspend certain contractual obligations contributes towards permitting NRAs to determine whether a resolution action is in the public interest, to decide on the most appropriate resolution tool/s and to ensure their effective application. This implies that, such power must be exercised before the institution or entity undergoes resolution. In light of the above, the BRRD2 has introduced such suspension power with a limited duration of a maximum of two working days. This suspension power can only be exercised if it is deemed necessary to avoid the further deterioration of the financial conditions of the entity or institution. Similar to the power available to Competent Authorities, this two-day power has also been extended to eligible deposits, however, subject to the necessary assessments. Notwithstanding, the BRRD2 has further clarified that Member States are required to allow a certain daily amount of withdrawals so as not to prejudice depositors in accessing their finances.