

THE MNB’S PRINCIPLES FOR SETTING MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL)

2021

**The objective of this document entitled ‘The MNB’s principles for setting Minimum Requirement for Own Funds and Eligible Liabilities (MREL)’ is to provide guidance for the public on how the MNB approaches the interpretation of certain regulatory provisions governing the determination of MREL. This document cannot be considered as information covering all of the prevailing legal provisions, and the individual circumstances of institutions may make it necessary for the MNB to apply an approach other than the ones set forth here in the case of a given institution when setting the MREL target or the deadline for compliance. In line with Article 8(3) of Commission Delegated Regulation (EU) 2016/1450, if there is a change in the factors taken as a basis, the MNB may review the content of this document and the MREL requirements set or the transitional period available for the implementation.**

***Budapest, 8 March 2021***

*EXECUTIVE SUMMARY*

***The MNB*** *first published the* ***document entitled ‘The MNB’s principles for setting Minimum requirement for own funds and eligible liabilities (MREL)’*** *on 14 November 2018.* ***The update of*** *the document* ***was necessitated by the banking system reform package that entered into force in the European Union on 27 June 2019 and the domestic legislation implementing the same.***

*The purpose of the document is to provide* ***transparency of the MNB methodology to market participants****: to present the framework for the determination, application, and compliance with the MREL requirement, and therefore, the document should* ***not*** *be considered as a* ***comprehensive*** *summary of the legislation.*

*In accordance with the Bank Recovery and Resolution Directive (BRRD) of the European Union, the Act on Resolution obliges the MNB as resolution authority to require the domestic credit institutions and investment firms to hold liabilities of adequate quantity and quality, which may partly or completely be written off or converted into capital in the case of a crisis situation. This minimum requirement for own funds and eligible liabilities (MREL) is determined individually, in line with the resolution strategy concerning the given institution, within the framework of the resolution planning, by the resolution authorities independently or within the resolution college in the case of institutions pursuing cross-border activities.*

***The MREL framework presented in this document covers six interrelated topics:***

1. *Scope of institutions on and the level at which MREL requirements are imposed and met*

*Under the revised legislation, taking into account the often complex structures of banking groups, the level of the MREL requirement, its calibration and the range of resources that can be taken into account for compliance will be adapted to the resolution strategy of the banking groups.*

1. *The assumptions based on which MNB determines the size of the requirement.*

*The MNB has adapted the calculation of the requirement to the new legal environment.*

*Chart 1:* *MREL requirement for bail-in tool*

Graphical user interface, application

Description automatically generated

*MREL TREA: a risk-based MREL requirement set as a proportion of the total risk exposure amount*

*MREL TEM: MREL requirement set as a proportion of the total exposure amount*

*Pillar 1: Pillar 1 capital requirement*

*Pillar 2: Pillar 2 capital requirement*

*Source: MNB*

1. *MREL requirements, eligibility and subordination requirements institutions must meet*

*The MNB explains the basically new rules and shares its principles regarding those.*

*In the case of Hungarian institutions, the MNB will designate the scope of institutions subject to Pillar 1 requirements based on their systemic risk importance. Taking into account that the MNB assesses the use of the bail-in tool in resolution plans by covering the decision criteria for the application of the Pillar 1 requirements in the legislation, the MNB applies these minimum requirements to all resolution entities where bail-in is the preferred resolution tool.*

1. *Principles for internal (individual) MREL requirements*

*As the internal MREL requirement is a new regulatory element, the MNB explains in detail the principles it will apply regarding the calibration of the requirement, application of waivers, the scope of eligible liabilities for meeting the requirement and the treatment of indirect group financing.*

1. *The timeframe and interim targets for meeting the requirements*

***Institutions required to comply with MREL requirements must comply with MREL requirements continuously from 1 January 2024 onwards.***

*Taking into account that the* ***MREL requirements under the new legislation will be first imposed in 2021****, the MNB does not impose a planned MREL level prior to the interim MREL target level to be met on 1 January 2022.* ***For the transitional period, the MNB will therefore set an interim mandatory target for 1 January 2022 and a planned MREL level for 1 January 2023.*** *These target levels are set by the MNB with a view to achieve the final MREL requirement on a linear path.*

1. *Limits on investments in MREL eligible instruments*

***The MNB does not consider it justified to exclude natural persons, micro, small and medium-sized enterprises from holding MREL eligible liabilities, or to set requirements for this that go beyond the legal requirements.***

*However, the investment of institutions in MREL eligible instruments poses a potential contagion risk in the case of large or highly concentrated portfolios. Therefore, the MNB monitors the risk of institutions' investments in MREL eligible instruments and if* ***an institution's investment portfolio******shows a high concentration of exposure to individual institutions, the MNB treats this as potential impediment to resolvability, which justifies the imposition of an additional MREL requirement.***

# The need to review the principles for imposing the MREL requirement

On 26 December 2020, the provisions of the Act on Resolution entered into force to transpose the revised rules of the Bank Recovery and Resolution Directive (BRRD)significantly amending the rules on the Minimum Requirements for Own funds and Eligible Liabilities (MREL).

The MNB, acting as resolution authority, has revised its “MNB's Principles for imposing the MREL requirement”, published on 14 November 2018, in order to keep its enforcement practice up-to-date and to facilitate compliance with the changed regulation for the MREL requirement by the institutions concerned.

From 1 January 2021, the MNB, acting as resolution authority, will seek to determine MREL requirements for institutions registered in Hungary and other potentially affected entities along the principles set out in this document and will represent its views accordingly in the relevant resolution colleges.

For compliance with the legislation and to provide a level playing field, MNB continuously monitors the changes in international regulations and in the practices of other authorities and reviews its practice if necessary.

# Introduction

One of the key principles of the resolution framework is that in case of a crisis situation of credit institutions and investment firms (hereinafter jointly: institutions) the losses should primarily be borne by the owners of the institutions, then by its creditors, thus making it possible to avoid or minimise the use of public funds for crisis management.

In order to enforce this principle, the BRRD[[1]](#footnote-1) and the Act on Resolution[[2]](#footnote-2) implementing the provisions of the Directive in Hungary introduced strict requirements on the liability structure of the institutions, which are to be met on a continuous basis, similarly to the capital requirements. Regarding the minimum requirement for own funds and eligible liabilities (MREL), it requires the holding of liabilities of adequate quantity and quality to allow their partial or complete write-off or conversion to equity in the case of a situation that makes the resolution action necessary, thus ensuring the bearing of losses by owners and creditors as well as the efficiency of the resolution actions. The MREL requirement serves not only the feasibility of bail-in, but it enables efficient implementation of all resolution tools through the availability of sufficient amount of liabilities with loss-absorbing capacity that can be used for recapitalisation and for ensuring market confidence, which facilitates maintaining of the critical functions while minimising involvement of public funds.

In Hungary, the detailed criteria for setting the MREL requirement are basically governed by the Act on Resolution. The European Commission's Delegated Regulation 2016/1450[[3]](#footnote-3) (the “MREL Regulation”) remains in force, and its provisions need to be applied to issues not covered by the BRRD and the transposing Act on Resolution. The legislation, although supplemented by a statutory minimum for the largest institutions, still does not set a uniform MREL requirement, and in principle the resolution authority will determine the MREL requirement for each institution and other entities subject to the MREL requirement on the basis of an individual assessment and analysis in accordance with the relevant resolution strategy. The requirement for the institutions and groups of institutions registered in Hungary and which do not carry out cross-border activities is determined by the Central Bank of Hungary (hereinafter: MNB) as resolution authority, while in the case of cross-border institutions – as a main rule – the MREL requirements at consolidated and individual levels are set by the resolution authorities concerned, within the framework of their cooperation in resolution colleges.

**The MREL framework presented in this document covers six interrelated topics:**

1) Scope of institutions on and the level at which MREL requirements are imposed and met;

2) The assumptions based on which MNB determines the size of the requirement;

3) The quality of liabilitiesinstitutions must meet the requirements with and the subordination requirements institutions must meet;

4) Rules for compliance with specific (internal) MREL requirements;

5) The timeframe and interim targets for meeting the requirements.

6) Limits on investments in MREL eligible instruments.

# The scope of institutions concerned and the level of determination of the MREL requirement

Under the revised framework, taking into account the often complex structures of banking groups, the level of the MREL requirement, its calibration and the range of resources that can be taken into account for compliance will be adapted to the resolution strategy of the banking groups. To this end, the regulation introduces, *inter alia*, the concepts of ‘**resolution entity’[[4]](#footnote-4)** and the ‘**resolution group’**[[5]](#footnote-5). A resolution group essentially comprises the resolution entity where the resolution authority would intervene and its subsidiaries (the ‘non-resolution entities’). Within a banking group, a particular resolution group is composed of a resolution entity (intervention point) and its subsidiaries (‘non-resolution entities’), which are resolved jointly with the resolution entity through loss absorption and capital flow[[6]](#footnote-6).

Resolution groups are established in the resolution plan according to the preferred resolution strategy and may differ from the prudential group definition. Based on a uniform methodology developed in accordance with Article 25 of the European Commission Delegated Regulation 2016/1075/EU[[7]](#footnote-7) laying down detailed rules for resolution planning, the MNB shall set out in the resolution plan of each group of institutions the preferred approach to a potential resolution, based on an assessment of the structure, operational, funding and governance interconnectedness of the group, in particular the applicability of the envisaged resolution tools at the point of intervention, by setting out the preferred single point of entry (SPE) or multi point of entry (MPE) strategy. In the context of the preferred resolution strategy, the resolution plan shall identify the resolution entities within the banking group and the scope of the entities that belong to each of the resolution groups of the resolution entities. Given that resolution planning, and in particular the setting of the MREL requirement, relies fundamentally on the supervisory reporting of institutions and supervisory capital requirements, the MNB takes the prudential consolidation scope as a starting point when establishing a resolution group or determining the scope of Hungarian resident entities in a given resolution group. Therefore, all subsidiaries of a resolution entity, including subsidiaries not subject to the Act on Resolution, which belong to consolidated supervision with the institution, are included in the resolution group belonging to the resolution entity.

The MNB will impose MREL requirements on all credit institutions and investment firms, financial holding companies, mixed financial holding companies, mixed-activity holding companies, financial undertakings registered in Hungary subject to consolidated supervision, all of which are resolution entities, along the principles set out in the following chapters. The MNB will impose the MREL requirement in all cases for credit institutions and investment firms that are not resolution entities themselves (non-resolution entities). For financial enterprises subject to the Act on Resolution that are non-resolution entities, the MNB will decide on the need to impose an MREL requirement on an individual basis, taking into account the characteristics of the group and financial enterprise concerned.

The MREL requirement for resolution entities will be imposed at the level of the resolution group to which they belong on a consolidated basis, while for non-resolution entities an individual MREL requirement will be imposed. By way of derogation, for EU parent companies that are subsidiaries of a third country entity and are non-resolution entities, a consolidated requirement will be imposed. In the case of a resolution group consisting of a central body and credit institutions permanently affiliated to it[[8]](#footnote-8), the resolution authority shall determine the resolution entities to meet the consolidated requirement.

The basic elements of the determination of the MREL requirement, common to both the consolidated and the individual requirement, are set out in Chapter 4. The specific rules for the individual (internal) MREL requirement for non-resolution entities and the principles for waivers from the internal MREL requirement are summarised in Chapter 6.

# level of the MREL requirement

In terms of its objectives, the MREL requirement consists of two components: the **loss absorbing amount** (LAA), which ensures that the resources of the institution cover the losses that occur in a potential crisis situation, and the **recapitalisation amount** (RCA), which is necessary to meet prudential requirements after resolution, and is needed to restore the capital adequacy, i.e. reaching the capital adequacy ratio necessary for compliance with the conditions for authorisation as well as for the maintenance of market confidence over a period of up to one year.

The determination of the MREL requirement has changed as a consequence of the amendment to the BRRD. In addition to the risk-based MREL requirement to be determined linked to a capital requirement, a less risk-sensitive MREL requirement, linked to the leverage ratio introduced in the CRR, is also required. In addition, the basis for benchmark of the requirement, the denominator of the MREL ratio, will also change.

Whereas previously the MREL requirement was expressed as a percentage of Total Liabilities including Own Funds (TLOF), the new regulation requires the MREL requirement to be determined as two ratios to be met in parallel:

* on one hand, as a percentage of the **Total Risk Exposure Amount[[9]](#footnote-9)** (TREA or Risk Weighted Assets - RWA) (**MREL-TREA**)[[10]](#footnote-10);
* on the other hand, as a percentage of the **Total Exposure Measure[[11]](#footnote-11)** (TEM) (**MREL-TEM**)[[12]](#footnote-12);

## Loss absorption amount

In the case of risk-based calibration of the loss absorbing amount (MREL-TREA), the default amount in the new regulation does not include the combined buffer requirement, unlike in the previous regulation.

The default amount of the loss absorbing amount is the same for a resolution entity at the consolidated level of the resolution group, and for a non-resolution entity at the individual level, it equals to:

* for MREL-TREA, the institution's regulatory capital requirement without a combined buffer requirement, i.e. the sum of the Pillar 1 (P1) and Pillar 2 (P2R) capital requirements;
* for MREL-TEM, the amount required to meet the 3 % leverage ratio.

## Recapitalisation amount

### **The factors that determine the necessary amount of recapitalisation**

Upon determining the recapitalisation amount, the resolution authority – in consultation with the Supervision – estimates how much of own funds the institution will need following the implementation of the preferred resolution strategy identified in the resolution planning process. In addition, if the resolution strategy assumes the continuous operation of the institution or a part of it, following the implementation of the preferred resolution strategy the determined recapitalisation amount may not be lower than the amount necessary for meeting the capital requirements and the requirements related to the leverage ratio in order to comply with the conditions of authorisation.

The efficient application of resolution tools and the successful implementation of the resolution is supported, while the necessity of using taxpayers’ money is reduced if the resources of the Resolution Fund are available for financing the resolution. Its essential condition laid down in Section 60(2) of the Act on Resolution is that at the time of the resolution, it is ensured that based on the independent valuation the institution’s shareholders and creditors (involved in the bail-in) bear the losses within the framework of implementing the bail-in at least to an extent corresponding to 8% of the total liabilities and own funds (TLOF) of the institution (bail-in rule)[[13]](#footnote-13). Therefore, in case of institutions for whom MNB considers the application of a resolution tool in their resolution plans justified as according to its assessment liquidation is not a credible or feasible means for the exit from the market in the case of a possible crisis situation, when determining the MREL requirement the MNB also considers ensuring access to the resources of the Resolution Fund. In case of all institutions where the resolution plan assumes further operation of the institution after resolution, the MREL level consistent with the above bail in rule constitutes the floor for the MREL target. In addition, where based on the resolution authority's assessment the need to maintain market confidence to ensure the funding of the institution for a period of up to 1 year after the implementation of the resolution strategy so justifies, the recapitalisation amount may be increased by an element above the minimum capital requirement, which serves maintaining the market confidence in the institution or entity after resolution. The default level of this market confidence charge is the amount of the combined buffer requirement less the amount of the countercyclical capital buffer. Where the imposition of a market confidence charge is justified, the resolution authority shall assess, in consultation with the Supervision, whether a deviation from the default amount is necessary. The required amount should be sufficient to maintain market confidence after the implementation of the resolution strategy and to enable the institution or entity to maintain critical functions on an ongoing basis and to obtain funding without the need for extraordinary public financial support or recourse to the Resolution Fund.

Accordingly, the recapitalisation amount is fundamentally affected by the type of resolution tool to be applied in the case of a given institution and by the fact whether the institution or a part of it continues to function after resolution, or the institution is withdrawn from the market. If the resolution plan foresees the use of a resolution tool and the institution continues its operation after the resolution or a part of it is transferred to a bridge institution and continues its operations like that it has to comply with the supervisory capital requirement and the leverage ratio requirement during and after the resolution. Accordingly, a recapitalisation amount needs to be imposed in any case.

### **Determining the recapitalisation amount in the event of the exit of an institution from the market**

In the case of institutions for whom liquidation is deemed credible and feasible to exit from the market in the case of a possible crisis situation according to the assessment by the MNB, and thus no resolution tool is justified in their resolution plan, according to Section 67(3) of the Act on Resolution, the resolution authority is required to assess and reason whether or not limiting the MREL requirement to the loss absorbing amount is sufficient to maintain financial stability and keep the risk of contagion low. Considering firstly that upon determining the supervisory capital requirement (default loss absorbing amount) MNB assesses and quantifies the risks of each institution and group of institutions comprehensively and prudently, and monitors the risks and capital adequacy of the institutions within the framework of ongoing supervision as well, and secondly that the MNB has not identified any material contagion risks in this scope of institutions in the course of resolution planning, **the MNB currently does not consider it justified and necessary to impose an MREL requirement in excess of the loss absorbing amount.** However, in the case of an individual assessment of such an institution, a change to the default loss absorbing amount may be justified if the assessment identifies that the institution's asset quality, business model or other deficiencies may have adverse effects on financial stability or the resolvability assessment identifies potential contagion effects, or risks of contagion of losses to the financial system.

### **Determination of recapitalisation amount for bail-in as preferred resolution tool**

If the resolution strategy laid down in the resolution plan of an institution aims at maintaining the operations of the institution as a whole or of a part of it, bail-in is applied as a resolution tool on its own or combined with other resolution tools (sale of business or asset separation) (in the case of non-resolution entities the recapitalisation of the parent company), in addition to the loss absorbing amount, which equals the capital requirement, it is also necessary to impose a recapitalisation amount. Its level is determined by the sum total of the institution’s expected capital requirement and leverage ratio after the implementation of the resolution strategy, which in turn depends on the total risk exposure amount (TREA or total RWA) total exposure ratio (TEM) of the remaining institution or remaining part of the institution and the applicable regulatory capital requirement.

The default amount of the recapitalisation amount (RCA) is the same for a resolution entity at consolidated level of the resolution group, and for a non-resolution entity at individual level, it equals to:

* for MREL TREA, the institution's regulatory capital requirement without a combined buffer requirement, i.e. the sum of the Pillar 1 and Pillar 2 capital requirements;
* for MREL TEM, the amount required to meet the 3 % leverage ratio.

When estimating the regulatory capital needs after implementation of the preferred resolution strategy, the resolution authority needs to use the values for the relevant total risk exposure amount and total exposure amount available from the latest supervisory report of the institution. The most recent available exposure figures need to be adjusted for the effects of changes resulting from the resolution measures set out in the resolution plan and, in the case of a risk-based requirement, for any changes in the level of the supervisory (Pillar 2) capital requirement. The exposure amount following the implementation of the resolution measure and the applicable capital requirement shall be determined by the resolution authority in consultation with the Supervision.

The following paragraphs summarise the assumptions used to quantify the recapitalisation amount. The principles presented apply to the internal MREL requirements for non-resolution entities, with the additions and deviations described in Chapter 6.

#### **Scope of institutions taken into account when determining the recapitalisation amount**

When imposing the consolidated requirement for a resolution entity, the MNB determines the recapitalisation amount based on the total risk exposure amount or total exposure amount consolidated at the level of the resolution group. In determining the recapitalisation amount the MNB takes into consideration if the preferred resolution strategy set out in the resolution plan assumes the liquidation of certain subsidiaries. When determining the recapitalisation amount, the MNB adjusts the total risk exposure and the total exposure amount for the risk exposures and the total exposure amount of these subsidiaries, respectively. When determining the recapitalisation amount, the MNB takes into account the contribution of subsidiaries to the total risk exposure and the capital requirement on the basis of the overall capital requirement including the Pillar 2 add-ons, if individual Pillar 2 capital requirements are available. If not, the MNB takes the respective Pillar 1 capital requirements as a basis.

In the case of domestic subsidiaries of EU parent companies that are non-resolution entities but whose subsidiaries under consolidated supervision are part of the same resolution group, the MNB will use the sub-consolidated risk exposure amount or total exposure amount consolidated at the level of the domestic group of institutions. For more information, see subsection 6.2.2 on the determination of internal MREL requirements.

#### **Calibration of recapitalisation amount in the case of a bail-in strategy**

If the preferred resolution strategy of the institution is open-bank bail-in, the MNB adjusts the value of the total risk exposure amount only for the impact of the balance sheet contraction as a result of loss absorbed in resolution.

The impact of the loss resulting in resolution on the value of the total risk exposure amount and thus on the own fund requirement and leverage requirement is quantified by the MNB in the resolution plans based on a common methodology. The starting point of the methodology is that in the case of a potential stress situation leading to resolution – typically assuming a credit risk event – the remaining institution’s credit risk exposure and thus its total RWA declines with the extent of the loss suffered in the stress situation.

When estimating the post-resolution capital requirement, the MNB assumes the current Pillar 2 capital requirement (P2%) to remain unchanged, as a result of the consultation between the resolution authority and the Supervision. This assumption is consistent with the assumption of loss resulting in resolution according to which such loss is not generated on a specific sub-portfolio but on the credit portfolio as a whole, with the degree of risk exposure decreasing with the average credit risk weight. Article 45c(4) of the BRRD empowers the European Banking Authority to develop regulatory technical standards for the determination of capital requirements applicable after resolution. Once these detailed rules are adopted, the MNB will, if necessary, revise its methodology by taking them into account.

**Quantifying the impact of the balance sheet contraction as a consequence of loss resulting in resolution**

The impact of the loss leading to resolution on the recapitalisation amount is calculated by the MNB assuming losses stemming from credit risk events. In the assumed stress scenario, the decline in capital requirement following the loss leading to resolution results from the decrease in the credit risk exposure and the credit risk capital requirement. Accordingly, the MNB reduces the recapitalisation amount by the credit risk capital requirement of the presumed loan losses equalling to the institution’s overall supervisory capital requirement that also includes the Pillar 2 add-ons (total loss absorption amount). During this calculation, in the first step the MNB determines the value of the total RWA including Pillar 2 adjustments reduced by the effect of the presumed credit risk loss, then, on the basis of the thus estimated RWA value it determines the post-resolution capital requirement.

By this, the MNB quantifies – both for resolution entities and non-resolution entities – the change in credit risk RWA using a ***common methodology*** but taking into account the individual portfolio characteristics and risk parameters applied in the ICAAP reviews of each institution. As a result, the determination of the total RWA decline assumed in the MREL setting is based on data consistent with the SREP capital requirements and is ***transparent*** for the institutions.

In determining the total RWA containing Pillar 2 adjustments that is reduced by the effect of the assumed loss, the MNB takes into account the value of the total risk exposure (RWA) indicated in the institution’s most recent available COREP report, multiplying it by the percentage decline in RWA determined for the reference date of the ICAAP review.

The recapitalisation amount is determined as shown below:

* Extent of the change in RWA () considered:

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where is the value (in HUF) of the institution’s supervisory capital requirement also including Pillar 2 adjustments (P1+P2 indicates the value of the credit risk exposure (Exposure at default), while indicates the value of risk weighted assets for credit risk as established during the most recent ICAAP review.

* RWA after resolution ()

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* Recapitalisation amount (*RCA*):

In the TEM-based calibration, the MNB assumes a decrease in the total exposure measure proportional to the decrease in the RWA.

The recapitalisation amount (RC-TEM) is:

#### **Calibration of recapitalisation amount in the case of applying additional resolution tools complementing the bail-in**

When determining the recapitalisation amount, it is possible to take into account the decline in risk exposure exceeding the balance sheet depletion as a result of the losses absorbed in resolution if during the implementation of the resolution strategy the resolution authority is planning to apply, in addition to the bail-in resolution tool, another resolution tool as well that significantly reduces the size of the remaining institution (typically a resolution tool entailing transfer of assets).

In this case, when calculating the recapitalisation amount, the resolution authority reduces the value of the total risk exposure available from the institution’s most recent supervisory report by the extent of the change in exposure resulting of the additional resolution tool planned to be applied. A precondition of the above is that the resolution plan identifies, explains and quantifies the changes in regulatory capital needs, and these changes should be considered both feasible and credible in the resolvability assessment, without adversely affecting the provision of critical functions by the institution and without necessitating recourse to extraordinary financial support from the state. Explanation and justification of the feasibility and credibility of the decline in exposure are especially necessary if the application of the resolution tool also depends on the actions of a third person, potential buyer or recipient.

The application of other resolution tools simultaneously with the bail-in can be considered credible if the resolution plan lays down the detailed restructuring plan ensuring the maintenance of critical functions, the achievement of the resolution objectives and ensuring the business viability of the remaining institution. At the same time the restructuring (remaining RWA) plan shall also present the impact of its implementation on the change in risk exposure amount. For this the institution shall submit its proposed restructuring (remaining RWA) plan supporting the implementation of additional restructuring tools to the MNB and it is assessed by the MNB, or in the case of decision-making by the resolution college by the resolution authority members of the institution’s resolution college. In this case the recapitalisation amount **may be set based on the RWA plan included in the restructuring plan assessed and accepted by the resolution authorities and built into the resolution plan.**

Considering that pursuant to the above statutory provision only the change in risk exposure resulting of the resolution action can be taken into account, the recapitalisation amount may only be reduced as a result of the application of resolution tools if the resolution (the application of resolution actions) takes place at the level of the given institution. Therefore, for non-resolution entities, where writing off the losses and recapitalisation of the institution is achieved through resolution actions applied to the parent bank, the potential for RWA reductions to absorb losses is limited.

#### **Calibration of the market confidence charge**

The BRRD and the Resolution Law continue to provide for the possibility for resolution authorities to increase the recapitalisation amount by the amount necessary to maintain market confidence (market confidence charge) for both resolution entities and non-resolution entities. If the resolution authority considers that such a determination is necessary, the amount should be determined on the basis of the combined capital buffers, reduced by the amount of the institution-specific countercyclical capital buffer.

The BRRD and the Resolution Law also allow the resolution authority to set the amount of capital necessary to restore market confidence at a different level than the amount of the combined capital buffers less the countercyclical capital buffer for each institution, if it considers that a different amount of market confidence charge is necessary to restore market confidence, to perform the institution's critical economic functions and to ensure access to funding over a one-year horizon after resolution without recourse to extraordinary public support or Resolution Fund resources.

The MNB conducts a two-step process to determine the market confidence charge. In the first step, it assesses whether an increase in the recapitalisation amount is necessary to enable the institution to maintain sufficient market confidence in itself for up to one year after resolution. If the resolution authority deems this necessary, it will assess in the second step, in consultation with the Supervision, whether a reduction or increase of the default amount of the market confidence charge is justified.

The MNB's assessment is that, at present, taking into account the funding structure of Hungarian institutions, in particular the high proportion of deposits, as well as the steady increase in deposit holdings, the lack of significant deposit concentration and the limited reliance on money and capital market sources in terms of funding, the funding of the institutions concerned following a possible resolution could be secured over the expected time horizon of up to one year without the imposition of the market confidence charge, if bail-in was to be applied. Furthermore, taking into account that the use of the bail-in tool ensures the continues operation and critical functions of the institutions, as assessed in the resolution plans, without recourse to public support or Resolution Fund financing, and that compliance with capital requirements ensures a sufficient degree of market confidence, also in comparison with peer institutions, the **MNB currently does not consider it justified to impose a market confidence charge as a default.**

The MNB will continue to regularly assess potential impediments to the funding and liquidity of institutions in resolution in its procedures for assessing the resolvability of institutions and, if identified, may impose a market confidence charge in individual cases.

Based on the above, the proposed MREL requirement is summarized in the chart below:

*Chart 2: MREL requirement for bail-in tool*

Graphical user interface, application

Description automatically generated

*Source: MNB*

# PRINCIPLES CONCERNING THE ELIGIBLE LIABILITIES FOR MEETING THE MREL REQUIREMENT

## Legal requirements and the eligibility of certain liabilities

In line with the changed calibration of the MREL requirement, the range of liabilitiesthat can be considered to meet the requirement has changed. Capital elements designed to meet the buffer requirements, determined as a proportion of the risk-based total risk exposure amount, are not eligible for the MREL requirement (MREL TREA). This restriction does not apply to the MREL TEM based on the leverage ratio, and the MNB will therefore take into account the total amount of own funds when assessing compliance with the MREL TEM.

The range of liabilities and own funds elements that can be taken into account to meet the MREL requirement is set out in Section 66 of the Act on Resolution for resolution entities and in Section 68/B(5) for non-resolution entities. Both statutory provisions refer to Articles 72a and 72b(1) and (2) of the CRR[[14]](#footnote-14), which must be taken into account when determining the MREL-eligibility of the relevant instrument[[15]](#footnote-15).

Since 2016, MNB assesses yearly the level of potentially MREL eligible liabilities at the institutions subject to the Act on Resolution on the basis of the data reported by the institutions. Based on the results of these analysis and findings of the institutions’ resolvability assessments carried out to date, as well as on the changes in the legislation the MNB considers further guiding necessary in three areas regarding assessment of the eligibility of certain liabilities.

**As default, irrespective of the contractual maturity of the deposit, liabilities resulting from deposit contracts are not considered MREL eligible by the MNB.** Considering that pursuant to Section 6:390(3) of the Civil Code the deposit holder is entitled to request repayment of the funds held on the account even before the expiry of the term specified in the contract, in a general case – if this right is not expressly excluded in the contract – the earliest time when the liability can be repaid is immediately, and thus deposits have to be considered as liabilities past due. It is possible to assess deposits differently if the institution justifies that in the case of the deposits concerned the deposit holder is not entitled to request repayment of the deposit within one year, and this justification is accepted by the MNB on the basis of its individual assessment.

**Refinancing loans granted by the Hungarian Development Bank (MFB) and Eximbank (EXIM) that have a maturity of over one year and are unsecured at the time of the evaluation are no longer accepted by the MNB** – as opposed to the temporary, conditional practice as a consequence of the change in legislation – **as liabilities eligible for meeting the MREL requirement**.

In addition to fulfilling the general conditions for MREL eligibility, **liabilities issued under the laws of third countries** may only be considered MREL-eligible if the parties to the contract that created the liability **expressly acknowledge in a contractual provision** (contractual provision) **that the liability concerned is eligible for bail-in by the MNB acting as resolution authority** and **consent to the exercise of the write-down, cancellation or conversion powers of the MNB acting as resolution authority.** In accordance with Section 72(7) of the Act on Resolution and Article 43 of the European Commission Delegated Regulation 2016/1075/EU, this condition shall not apply only for liabilities issued before the transposition of the BRRD by the Member States. Given that Section 72(7) of the Act on Resolution entered into force on 16 September 2014, the obligation to include the clause in the contract covers liabilities issued, created or substantially amended pursuant to Article 43 of Regulation (EU) No 2016/1075/EU after that date.

The content of the contractual provision must comply with the requirements set out in Article 44 of the Resolution Planning Regulation[[16]](#footnote-16). If an institution needs to **take into account liabilities issued under the law of a third country** for the purpose of meeting the MREL requirement, **the MNB, acting as resolution authority**, will **in any case require the institutions concerned to** submit **a legal opinion** **on the legal enforceability and validity of the condition included in the contractual provision** prepared by a lawyer, foreign legal adviser, European Community lawyer, having no other legal relationship other than an agency pursuant to the provisions of the Act LXXVII of 2017 on the professional activities of Lawyers. The legal opinion shall at least state that the MNB acting as resolution authority may exercise its write-down or conversion powers in respect of the relevant liability or that the decision to exercise such powers is enforceable in the relevant third country and that the additional requirements set out in Article 44 of the Resolution Planning Regulation are met.

The MNB, acting as resolution authority, shall refrain from including such a provision in the contract if it states in its decision that the decision to exercise its write-down or conversion powers is enforceable under the law of the third country or is ensured under a binding agreement with the third country. The institution must also provide a legal opinion on the fulfilment of these conditions at the request of the MNB acting as resolution authority.

Liabilities issued under the law of a third country may not be taken into account for the purpose of meeting the MREL requirement either, if there are impediments to inclusion of the contractual provision in the contract giving rise to the liability as provided for in Section 72(8a) of the Act on Resolution.

## Subordination requirements

By the application of the bail-in tool, if all the conditions of the resolution are jointly fulfilled, the MNB as resolution authority is entitled to involve other resources – in addition to the write-down and conversion of the institution’s capital elements and certain eligible liabilities, respectively – to cover the losses or for recapitalisation, such as writing off liabilities vis-à-vis creditors or their conversion into capital.

The scope of eligible liabilities for bail-in covers all outstanding liabilities of the institution, apart from certain liabilities explicitly excluded from the absorption of losses and bail-in due to the creditor’s position protected by law or for the effectiveness of the resolution of the institution, or for the provision of its critical functions or in order to maintain financial stability. In addition to the mandatory exceptions set out in the Act on Resolution[[17]](#footnote-17), the resolution authority may decide to exclude certain liabilities in whole or in part[[18]](#footnote-18), if in their case the application of bail-in is not possible or the value of the other claims included in the bail-in would be reduced to a greater extent than would be the case if the liability concerned were excluded from the bail-in.

The most important principle of the resolution framework serving the protection of creditors is that the losses of creditors suffered during the resolution cannot exceed the loss that they would have suffered during liquidation (‘no creditor worse off’, NCWO principle). For the enforcement of this, during the resolution, even if the bail-in exceptions determined by law are applied, the principle of equal treatment of creditors with the same ranking in the insolvency hierarchy, i.e. liabilities with the same ranking according to the insolvency hierarchy (not affected by exclusion), shall not be violated, liabilities with the same ranking according to the insolvency hierarchy have to bear the loss without discrimination, in a pro rata manner.

Requiring MREL-eligible liabilities to be subordinate to other liabilities eligible for bail-in is intended to ensure that these liabilities are used as a priority in any bail-in and to avoid, as far as possible, the NCWO principle being violated and the resulting opening up of compensation claims as a result of exclusions from bail-in. Subordination requirements can therefore play an important role in strengthening the resolvability of institutions. A key element of the change in the regulatory framework is the development of more detailed rules on the imposition of subordination requirements for the management of NCWO risks, differentiated according to the risks of the institutions. For systemically important institutions, the discretion of resolution authorities to assess the need for subordination requirements has been significantly reduced, with the Resolution Law imposing minimum requirements for this scope of institutions. Given that the NCWO risks are linked to the use of the bail-in resolution tool, these subordination requirements therefore apply to the points of intervention, the resolution entities.

Similarly to the minimum requirements for own funds and for eligible liabilities, the resolution entities must meet the subordination requirements on a consolidated basis at the level of the resolution group.

### **Categories of institutions**

In order to facilitate the resolvability of institutions and to mitigate the NCWO risk, the resolution law requires a limited number of institutions to meet the MREL with a certain amount of own funds and other subordinated liabilities. **Resolution entities are subject to differentiated subordination requirements depending on their size, their role in the financial intermediary system and their funding strategy.** The scope of institutions subject to the statutory minimum requirements (Pillar 1 institutions) is partly defined in the legislation and includes globally systemically important institutions (G-SIIs) and resolution entities of 'largest banking groups' with assets above EUR 100 billion. In addition, resolution authorities may, after consultation with the Supervision, apply the requirement applicable to the 'largest banking groups' to any resolution entity that is not part of a resolution group with a balance sheet total of up to EUR 100 billion but whose insolvency would, in the judgment of the resolution authority, pose a systemic risk[[19]](#footnote-19).

The MNB, as resolution authority, currently only has jurisdiction over resolution entities classified as "other significant institution", to which the mandatory subordination rules may be applied following consultation with the Supervision, based on the above decision.

**Based on the MNB's preliminary assessment, it is expected that the category "other significant institutions" (other Pillar 1 institutions) will predominantly include all resolution entities where the resolution plan includes the bail-in tool as the preferred resolution tool.** On the one hand, the systemic risk relevance of these institutions is underlined by the fact that they are typically assessed by the macro-prudential authority as other systemically important institutions (OSIIs) and that their liquidation, based on the assessment carried out at the time of resolution planning, would cause widespread disruption to the functioning of the financial intermediary system. On the other hand, the emergence of NCWO risks cannot be excluded with regard to their balance sheet structure, given that a significant part of the liabilities eligible for bail-in are deposits: their funding model is heavily weighted towards deposits and has a low proportion of debt instruments, their capital market presence is mostly very limited, although a significant part of their liabilities eligible for MREL requirements are equity, they will need additional significant fundraising to meet the requirement.

**The MNB, acting in its resolution function, may impose a subordination requirement, as in the previous legislative framework, also for a resolution entity where it has not decided to apply a statutory mandatory subordination, in order to mitigate NCWO risk.** In order to make the violation of the NCWO principle as a result of the exclusions from the bail-in and the related compensation claims as avoidable as possible, it is necessary, also in the current legislative framework, for resolution authorities to assess the NCWO risks for all other non-Pillar 1 or other Pillar 1 institutions and to ensure that the liabilities necessary for bail-in are available by taking into account the NCWO risks. Considering this, if the risk of violating the NCWO principle is high, in order to ensure resolvability, it may be justified for the resolution authority to determine further requirements also concerning the subordination of the MREL eligible liabilities not only their amount.

### **Statutory minimum requirements for other Pillar 1 institutions**

For resolution entities subject to the Pillar 1 statutory minimum requirements (mandatory subordination) as designated by the resolution authority’s decision (other Pillar 1 institutions), the new framework sets out two subordination requirements:

* A Pillar 1 MREL requirement of 13.5% of the total risk exposure amount (Pillar 1 MREL TREA) and 5% of the total exposure amount (Pillar 1 MREL\_TEM), to be met by own funds or by subordinated liabilities[[20]](#footnote-20) for all non-MREL eligible liabilities. To meet the Pillar 1 MREL TREA requirement, institutions may not use Tier 1 capital held to meet the combined buffer requirement[[21]](#footnote-21).
* The portion of the MREL requirement corresponding to 8% of the total liabilities including own funds (TLOF) must be met[[22]](#footnote-22) with subordinated liabilities[[23]](#footnote-23). If, for other Pillar 1 institutions, 8% of the TLOF is higher than the amount of the MREL TREA or MREL TEM requirement, the entire MREL requirement, which is less than 8% of the TLOF, must be met with subordinated liabilities.

The resolution authority may adjust the subordination requirement set at 8% of the TLOF upwards or downwards, within the limits set by the legislation, based on its assessment of NCWO risks.

The 8% minimum requirement may be reduced up to the following limits[[24]](#footnote-24):

where  means the total liabilities including own funds,

and the total risk exposure amount.

The application of the reduced requirement is subject to the conditions set out in Article 72b(3) of the CRR being met, in particular that the reduction of the subordination requirement does not increase the NCWO's risks, and that the institution's resolvability is adequately ensured.

For up to 30% of Pillar 1 institutions, the resolution authority may set the subordination requirement higher than the regulatory minimum[[25]](#footnote-25). This may take place where justified by a significant impediment to resolvability identified by the authority in its assessment of the institution's resolvability that cannot be eliminated,[[26]](#footnote-26) or by the limited credibility and feasibility of the resolution strategy, or by the institution's prudential risks[[27]](#footnote-27) as measured by its Pillar 2 capital requirements. In this case, the amount of the subordination requirement shall not exceed the following value[[28]](#footnote-28): *2 \* Pillar 1 + 2 \* Pillar 2 + Combined capital buffers*.

**The MNB, acting in its resolution function, is currently not adjusting upwards the Pillar 1 subordination requirement of 8% of the TLOF**, given that it has not identified any significant resolvability impediments for any other Pillar 1 resolution entity and that the assessment of resolution plans indicates that the implementation of the preferred resolution strategy is credible for all institutions. Also, given that the institutions concerned do not currently have sufficient MREL-eligible liabilities, in order to ensure the resolvability of the institutions, **the MNB does not currently apply a reduction of the Pillar 1 subordination requirement**.

**The need for a possible derogation from the Pillar 1 requirement will be reviewed by the MNB on a regular basis in the future for each institution on a case-by-case basis, based on the assessment in the context of the assessment of the legal conditions for resolvability.**

### **Subordination requirements for non-Pillar 1 institutions**

The resolution authority may also decide to impose a subordination requirement for entities not eligible for other Pillar 1 resolution, after consulting the Supervision, where significant NCWO risks are identified. This may be maximum 8% of TLOF and may be the higher of the upper limit of subordination requirement for Pillar 1 institutions and the sum of *2 \* Pillar 1 + 2 \* Pillar 2 + Combined capital buffers*. NCWO risk is identified if[[29]](#footnote-29):

* non-subordinated eligible liabilities rank the same in the insolvency hierarchy with liabilities excluded from the application of the write-down and conversion powers;
* there is a risk that through the application of the write-down and conversion powers to a non-subordinated liability not excluded from the write-down and conversion powers the creditors of such liabilities would suffer losses greater than would be the case in a liquidation under ordinary insolvency proceedings;
* and the amount of own funds and other subordinated liabilities is insufficient to avoid those risks.

Where the proportion of liabilities that are or are likely to be excluded from the application of bail-in within an institution's liability class containing eligible liabilities is higher than 10%, the resolution authority shall assess the risk under the second clause above and consult the Supervision.

When deciding on subordination, the MNB acting in its resolution function shall take into account the significance and business model of the institution, the availability and structure of the eligible liabilities, the maturity of liabilities, the amount and ranking of liabilities excluded from the application of the write-down and conversion powers, the possibility of issuing own funds instruments and subordinated eligible instruments, the possibilities for restructuring.

**Analysing the structure of MREL eligible liabilities of institutions established in Hungary, (for institutions other than other Pillar 1 institutions, in the current phase of the resolution planning the MNB did not identify any potential impediments to resolvability resulting from the violation of the NCWO principle that would necessitate the imposition of subordination requirements.** Nevertheless, the MNB continuously monitors the composition of institutions’ MREL eligible liabilities, and if NCWO aspects or amendments to the legislation justify, it will revise the framework of determining the MREL requirements and might formulate new qualitative requirements.

## Liabilities to be taken into account for the subordination requirement

The subordination requirement defined by the MNB acting in its resolution function in the MREL decisions for institutions, and in the case of other Pillar 1 institutions designated by MNB decision, the statutory minimum requirement applicable to them may be met by[[30]](#footnote-30) own funds, subordinated instruments eligible for write-down and liabilities under Section 66(6) of the Act on Resolution in accordance with the provisions of the Act on Resolution. The basic requirement for subordinated eligible instruments is that the claim on the principal amount of the instruments to be fully subordinated to the liabilities excluded from the eligible liabilities. The subordination condition may be met in the following cases:

* by contractual subordination, where the contractual provisions governing the liabilities specify that in a liquidation under ordinary insolvency proceedings the claim on the principal amount of the instruments is subordinated to claims arising from liabilities excluded from bail-in;
* subordinated by law, where the condition set out in the previous section is provided for by the applicable law;
* structural subordination, where the instruments are issued by a resolution entity whose balance sheet does not include liabilities excluded from bail-in that have the same ranking as eligible or junior liabilities.

Given that, on the one hand, pursuant to Article 57(1)(a), (b) and (c) of the Credit Institutions Act, claims arising from deposits rank before other liabilities to the institution in the insolvency hierarchy in the event of liquidation[[31]](#footnote-31) and that in this category, mainly due to short-term liabilities to financial institutions, there is a significant proportion of liabilities excluded from the eligible liabilities, **the** **subordination requirement cannot be met by deposits placed with an resolution entity**.

In addition to liabilities issued by the resolution entity that comply with the statutory criteria, certain instruments issued by a subsidiary of the resolution entity established in the European Union and belonging to the same resolution group to a minority shareholder outside the resolution group may be taken also into account for the purposes of the subordination requirement. The conditions of this and the upper limit of the amount that can be taken into account are set out in the Resolution Law[[32]](#footnote-32). When assessing these conditions, the MNB considers ensured that the exercise of the write-down and conversion power does not affect the control of the resolution entity over the subsidiary if the value of these liabilities does not exceed the value of the instruments issued to the parent (belonging to the same class of creditors) in any classes of creditors.

# Expectations for the specific (internal) MREL requirement

In order to ensure the effective implementation of the resolution strategy, non-resolution entities should also have sufficient loss absorbing and, where appropriate, recapitalisation capacity. This scope of institutions covers the domestic parent and its subsidiaries belonging to groups of institutions headquartered outside Hungary with a single point of entry (SPE) strategy, and within international groups with a multiple point of entry (MPE) strategy, the subsidiaries belonging to domestic resolution groups linked to the domestic parent with a local SPE strategy and their subsidiaries. In order to be able to remedy losses incurred by members of the resolution group without being subjected to resolution, subsidiaries are typically required to issue specific internal MREL-eligible liabilities to the parent (the intervention point in resolution), which can be written down or converted to absorb losses and, if necessary, restore capital levels required for operation.

## Defining the scope of entities concerned

Specific MREL requirement will be imposed on each institution belonging to a resolution group that is a resolution entity or a subsidiary of a third country entity subject to the Resolution Law that is not itself a resolution entity. It is also necessary to impose a specific MREL requirement in the case of a resolution group consisting of a central body and permanently affiliated credit institutions[[33]](#footnote-33) for group member non-resolution entities and for resolution entities that do not participate in meeting the consolidated requirement. In the case of financial undertakings subject to consolidated supervision that are domiciled in Hungary, the MNB, acting as resolution authority, shall consider the imposition of an internal MREL requirement on an individual basis. The criteria for the consideration are the same as those taken into account in 6.3.1 for deciding whether a recapitalisation amount is needed for an internal MREL requirement.

## Options for exemption from the internal MREL requirement

### **Mandatory exemption from the MREL requirement**

The Act on Resolution only provides for an **exemption obligation** from the MREL requirement for mortgage banks. Under Article 65(1), **resolution authorities must exempt from meeting the MREL requirement, subject to the conditions set out in the legislation,** mortgage credit institutions funded by covered bonds that are not allowed to collect deposits under national law. In the event that mortgage credit institutions meet the conditions for this type of exemption, no MREL requirement will be imposed on mortgage banks and the mortgage bank's exposures will not be taken into account in the determination of the MREL requirement calculated on a consolidated basis. An essential condition for the application of the statutory exemption is that the mortgage bank concerned is exited from the market under the resolution plan for the group of institutions, as a result of sale of business, bridge institution, asset separation or liquidation in a national insolvency procedure.

Therefore, those mortgage banks that are defined by the MNB in the resolution plan of the banking group as part of the group that remains after the resolution action are not subject to the above statutory exemption and are subject to the MREL requirement imposed by the MNB. The MNB currently assesses the activity of mortgage credit institutions as a **critical function** for all mortgage banks to ensure compliance with the MFAR indicator, and therefore in the resolution plans mortgage banks are form all cases part of the group that remains after the resolution action. In view of this, **according to the MNB's assessment the conditions for the statutory exemption of domestic mortgage banks are currently not met**, and that in their case, an exemption from the MREL requirement may be granted under the general exemption rules described in the next section, based on the resolution authority's decision.

### **Exemption based on the decision of the resolution authority**

In addition to the requirements set out in the previous section, the **resolution authority may grant an exemption from compliance with the specific MREL requirements**. Subsidiaries that are non-resolution entities may be exempted by the MNB from compliance with the specific MREL requirements if the conditions detailed in paragraphs (6) and (7) of Article 68/B of the Act on Resolution are met, from which we highlight three material substantive requirements:

* Both the subsidiary to be exempted and its parent company (or the resolution entity) are established in Hungary and belong to the same resolution group.
* The parent bank (or resolution entity) has adequate control over the subsidiary, both from a legal and prudential perspective, and no significant legal or practical impediment to the absorption of loss of the subsidiary, or to the allocation of capital if necessary, can be identified and is not expected to arise even in the event of resolution of the parent bank (or resolution entity).
* The parent (or resolution entity) complies with the MREL requirement, which also provides the funds that may be needed to implement resolution actions in the resolution plan affecting the subsidiary.

The MNB assesses the fulfilment of the legal conditions individually for each organisation concerned, in consultation with the Supervision.

In the case of domestic banking groups belonging to groups of institutions with an SPE strategy, there is therefore no possibility to exempt the Hungarian parent company from the internal MREL requirement, only its subsidiaries and their subsidiaries may be exempted. Within a group of institutions with a multiple point of entry (MPE) strategy, subsidiaries and their subsidiaries belonging to a domestic resolution group with a local SPE strategy affiliated to the domestic parent may be exempted from compliance with the internal MREL requirement, while the domestic parent, which is the resolution entity in this case, will meet a consolidated (external) MREL requirement.

When assessing the conditions for corporate governance and the free flow of funds, the MNB, acting in its resolution function, will base its assessment on the Supervision’s assessment, but will also consider other aspects. Therefore, the exemption of a subsidiary from certain requirements of the CRR granted by the Supervision is a necessary but not a sufficient condition for the conditions for exemption from the specific MREL requirement to be met. In addition to meeting the conditions for the exemptions granted by the Authority, when assessing the resolvability the MNB attaches great importance to the fact that, in the event of the simultaneous insolvency of the parent company and its subsidiary, the flow of funds necessary to absorb the losses of the subsidiaries and to recapitalise them, if necessary, can be ensured without hindrance.

If the MNB assesses that the statutory corporate governance conditions for exempting a domestic parent and its subsidiaries from compliance with the specific MREL requirement are met, it will impose a sub-consolidated MREL requirement for the domestic parent at the level of the domestic prudential group. If the domestic parent is a resolution entity belonging to a cross-border banking group with an SPE strategy, a consolidated requirement will be imposed as described in Chapter 3. When assessing the condition for exemption, the MNB assesses the fulfilment of the MREL obligation of the parent bank at the time of the decision. Taking this into account, in MREL decisions taken during 2021, the MNB will therefore consider the MREL condition for exemption to be fulfilled if the domestic parent company, on a consolidated or sub-consolidated basis, meets the given target level to be achieved in the MREL compliance path set out in the transitional period at the time of the decision.

If before 1 January 2024 the domestic parent company does not meet the minimum requirement for the mandatory interim target level (1 January 2022) at the time of the decision, its subsidiary will not be eligible for the exemption. In this case, the subsidiary will also have to comply with a specific MREL requirement (the mandatory interim target level and the final requirement level on 1 January 2024) and the MNB will also set for it the planned MREL for the transitional period. If the subsidiary is exempted by the MNB and the domestic parent does not comply with the interim target level on the date after the exemption, the subsidiary will also be required to comply with the interim target level set for 1 January 2022, or the final requirement from 1 January 2024, unless the conditions for exemption are fully met.

### **Exemption from compliance with the internal MREL requirement for institutions permanently affiliated to a central body, based on the decision of the resolution authority**

In line with the concept of a resolution group[[34]](#footnote-34), credit institutions and a central body which are permanently affiliated to a central body and which are non-resolution entities, and any resolution entity which is not subject to meet an external MREL requirement on a consolidated basis[[35]](#footnote-35), **shall meet the internal MREL requirement on an individual basis**.

The MNB may **exempt** the central body and credit institutions permanently affiliated to the central body from compliance with the specific MREL requirement, in whole or in part, if the conditions detailed in Section 68/C of the Act on Resolution are met. The content of these requirements corresponds to the conditions for exemption from compliance with the internal MREL requirement described in the previous section. Reflecting the special features of the prudential regulation of the scope of institutions, the requirement of corporate governance and risk management is complemented by the existence of joint and several liability and the criterion of joint compliance with capital requirements.

Also for entities within this scope of institutions, the exemption is conditional on the whole resolution group meeting the consolidated requirement. In assessing this criterion, the MNB will proceed as described in the section on the general rules for exemption.

If the MNB exempts an institution from compliance with the internal MREL requirement on the basis of the above, the institution will be **taken into account in the determination of the consolidated MREL requirement.**

## Determining the level of the internal MREL requirement

In determining the level of the internal MREL requirement, the MNB will apply the general principles set out in Chapter 4, taking into account the following considerations.

### **Need to require a recapitalisation amount**

**For some institutions and financial undertakings that are members of the resolution group, liquidation may be a credible and feasible way** to exit the entity concerned from the market. There is no justification to keep these institutions in operation after resolution and therefore, in their case, there is **no need to require a recapitalisation amount** in line with the general rules for determining the MREL requirement as described in chapter 4.2.2.

For those group members that continue to operate as part of the group after the implementation of the preferred resolution actions as set out in the resolution plan, i.e. **are part of the group after the resolution measure, the MNB will assess the extent to which it is necessary to require a recapitalisation amount ensuring the conditions for continued operation to be met.**

The group established as a result of the resolution action will be defined by the MNB in the resolution plan. The justification for determining the recapitalisation amount will be determined by an individual assessment of the critical functions and materiality of each member of the group established as a result of the resolution action.

When assessing the **critical function**, the MNB examines which of the institutions in the resolution group have a critical function according to the MNB's top-down assessment, as the maintenance of these critical functions requires the availability of sufficient quantity and quality of internal MREL in case the resolution strategy is implemented.

A **material** group member is an entity which, according to the assessment of the group leader institution, qualifies as a material **undertaking** **affected by the recovery plan** on the basis of the criteria set out in Regulation 2016/1075[[36]](#footnote-36). These material subsidiaries according to the assessment criteria are:

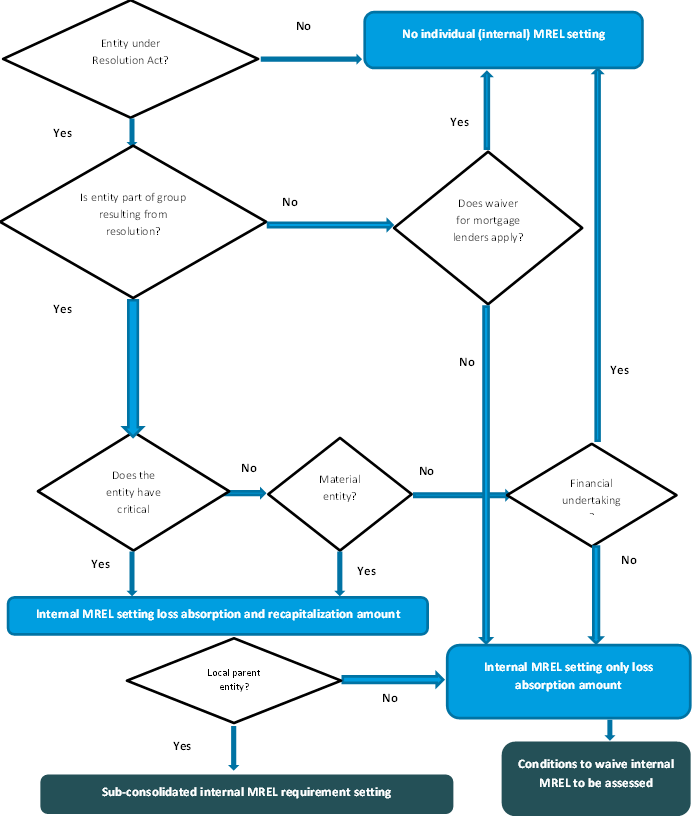
* make a significant contribution to the profits or financing of the undertaking or undertakings affected by the recovery plan, or hold a substantial part of their assets, liabilities or capital;
* are engaged in key commercial activities;
* perform key operational, risk management or administrative functions centrally;
* bear a material risk that, in a worst-case scenario, could threaten the viability of the institution or group;
* they cannot be sold or wound up without likely significant risk to the institution or the group as a whole;
* are important for the financial stability of at least one of the Member States in which they are established or operate.

If the group leader institution has not assessed the materiality of its subsidiaries, the MNB will carry out its own assessment, taking into account the above criteria.

The MNB also sets a recapitalisation amount for material subsidiaries with critical function when determining the internal MREL requirement.

The process for determining the internal MREL requirement is summarised in the chart below.

*Chart 3: Process of determining internal MREL*

**

*Source: MNB*

### **Taking Pillar 2 capital requirements into account when determining the internal MREL**

When determining the risk-based internal MREL requirement (MREL TREA) for non-resolution entities, the resolution authority will take into account the Pillar 2 (supervisory) capital requirement (P2R) of the institution concerned when calculating the amount and recapitalisation amount. If, during the supervisory review of the ICAAP (SREP), no Pillar 2 capital requirement has been determined for or allocated to the institution individually, the MNB will use a value equal to the group (consolidated or sub-consolidated) Pillar 2 capital requirement (P2R) determined for the banking group or, in the case of domestic subsidiaries of EU-based banking groups, the domestic banking group, taking into account the risk profile of the institution, when determining the individual MREL requirement.

In the case where an internal MREL is required to be set for the institution, but the institution is not subject to a Pillar 2 requirement under the relevant regulation, since following the write-down or conversion of the relevant capital instruments and the eligible liabilities there is no need to estimate Pillar 2 capital requirements, the MNB assumes Pillar 2 capital requirement is to be 0% when determining the loss absorbing or recapitalisation amount and the internal MREL requirement is determined on the basis of the Pillar 1 (regulatory) capital requirement.

If the institution is legally exempted from compliance with the individual Pillar 2 capital requirements, the Pillar 2 capital requirement at the consolidated (sub-consolidated) level of the domestic banking group is applied to the relevant institution, while for non-material, so-called small member institutions, the internal MREL is determined only on the basis of the Pillar 1 capital requirement.

## Liabilities other than own funds eligible for internal MREL

### **Expectations for eligible liabilities**

Eligibility for the internal MREL requires that the non-resolution entity (hereinafter for the purposes of this Chapter referred to as the subsidiary) issues the liability to the resolution entity which directly or indirectly purchases it or is purchased by a shareholder that is not part of the same resolution group of which the subsidiary is a member, with the proviso that the control of the resolution entity over the subsidiary remains unchanged even in the event of a write-down or conversion of the liabilities. **Liabilities that meet the conditions for external MREL eligibility (except for Article 72b(2)(b), (c), (k), (l) and (m) and Article 72b(3) to (5) of the CRR)** may be eligible for the internal MREL for which the conditions set out in Article 68/B(5) of the Act on Resolution are met, including the following:

* is subscribed directly or indirectly by the resolution entity, including by a (minority) shareholder outside the resolution group, where the control of the resolution entity over the subsidiary is not likely to change in the event of a write-down or conversion of liabilities;
* are subordinated to other liabilities issued to non-shareholders and do not constitute own funds;
* acquisition is not financed directly or indirectly by the subsidiary;
* the liability is not callable, redeemable, repayable or subject to early repayment by an non-resolution entity (other than in insolvency or liquidation);
* the shareholder (other than in the event of insolvency or liquidation) is not entitled to claim early payment of interest or principal compared to the future payment schedule;
* the level of interest or dividend payments due should not be adjusted based on the creditworthiness of the subsidiary or its parent company;

in addition, **own funds** which are core Tier 1 capital or an element of own funds issued to other members of the resolution group, possibly to a party outside the resolution group, provided that the write-down/conversion does not affect the control over the subsidiary.

As a result of the above criteria, the MNB expects that **all internal MREL liabilities that are not own funds should be subordinated to other liabilities of the institution issued to shareholders** so that the exercise of any write-down or conversion powers does not alter the control of the resolution entity over the subsidiary and that the NCWO principle is not violated. As regards the control over the subsidiary, the expectations set out in chapter 5, under the general conditions for MREL-eligible liabilities, apply.

The MNB does not explicitly expect a subordination form of internal MREL[[37]](#footnote-37), in particular given that it could lead to excessive complexity due to the different regulation of foreign subsidiaries of some domestic banking groups. The parent company shall design the form and composition of the internal MREL provided to the subsidiary in line with the form of the external MREL instruments it issues, in such a way as to support the feasibility of the resolution strategy, taking into account the condition already highlighted above that all internal MREL not being own funds must be subordinated to the other liabilities of the institution.

At the same time, in line with the requirements in Chapter 5.3 on the liabilities that are acceptable to meet the subordination requirement – given that pursuant to Article 57(1)(a), (b) and (c) of the Credit Institutions Act, claims arising from deposits rank before other liabilities to the institution in the insolvency hierarchy in the event of liquidation – in the case of deposits, structural subordination is not ensured and therefore the **internal MREL requirement cannot be met by deposits from a shareholder (or other group member) placed with an non-resolution entity.**

### **Meeting the internal MREL requirement with guarantees**

The MNB expects that the liabilities to meet the internal MREL requirement to be fully available in the entities subject to compliance. However, if the subsidiary and the resolution entity are both established in Hungary and are members of the same resolution group, and the resolution entity meets the external (consolidated) MREL requirement for the resolution group as a whole, the MNB may, upon request, allow the subsidiary to ensure compliance with the internal MREL requirement, **in whole or in part, by means of a guarantee from the resolution entity**.The MNB will allow this if the conditions set out in Section 68/B (8) of the Act on Resolution are met, including the following:

* the guarantee has been provided in an **amount** at least equivalent to the amount of the requirement that the guarantee is replacing,
* the guarantee may be called when the subsidiary is unable to meet its obligations as they fall due or when the MNB exercises its right to write down and/or convert the relevant capital elements if the resolution conditions are met,
* **is covered** by a collateral considered to be a financial collateral of **at least 50 %** of the amount of the guarantee**[[38]](#footnote-38)**.

Cover of the guarantee:

* has an **effective maturity date** that meets the maturity criteria for eligible liability instruments,
* meets the conditions for **eligibility of collateral under all approaches and methods**[[39]](#footnote-39) and is sufficient to cover the amount secured even after the **application of appropriately conservative haircuts**,
* is **unencumbered** and does not serve as security for other guarantees, and
* there is no legal, regulatory or operational impediment to the **transfer** from the resolution entity to the subsidiary concerned, even if the resolution entity is subject to a resolution action.

In principle, the MNB expects guarantees to meet the internal MREL requirement to be 50 % collateralised, but may set higher collateral requirements on a case-by-case basis. In accordance with Section 68/B(9) of the Act on Resolution, the resolution authority requires the resolution entity to submit a reasoned legal opinion in order to demonstrate that there are no obstacles to the enforcement of the collateral.

## Treatment of financial interlinkages (Daisy chains)

The MNB intends to regulate the **indirect issuance of internal MREL**, in line with the EBA guidelines currently under consultation[[40]](#footnote-40). In order to properly account for the MREL-eligible liabilities issued within a group, it is necessary to establish principles for the treatment of indirect group financing relationships. Failure to do so may result in double counting, internal MREL liabilities that the institution issues, in whole or in part, **indirectly** to members of the resolution group that are non-resolution entities. In line with the EBA's envisaged guidance, the MNB's objective is that the amount of liabilities eligible for compliance with the internal MREL requirement, regardless of the forms of group financing, should ultimately be as much internal MREL to be taken into account for individual compliance purposes as if the institution had issued all of those liabilities to the resolution entity.

*Chart 4: Fundamental indirect forms of group financing*



*Source: MNB*

Indirect financing should not jeopardise the effective implementation of the SPE strategy, i.e. the flow of losses from the subsidiary to the resolution entity (typically the parent company) and the flow of capital from the parent company to the subsidiary. In the cases shown in the charts above, the MNB will manage the potential problems arising from the MREL instruments not actually available in the case of indirect funding (double counting cases) by means of **deduction** where the intermediate subsidiary (Subsidiary 1) is also an institution subject to the Act on Resolution, i.e. subject to the internal MREL requirement. The MNB will therefore deduct in full from the elements eligible for the internal MREL of the subsidiary providing the indirect financing the elements provided for the internal MREL compliance of the other institution within the resolution group (Subsidiary 2). The amount of the deduction is equal to the total amount of financing provided, so if the cross-financing exceeds the liabilities needed to meet the internal MREL requirement, the deduction may also exceed the amount of the internal MREL requirement of the financed group member[[41]](#footnote-41).

**Where a subsidiary at the bottom of the group financing chain within the resolution group has issued its internal MREL to another group member, the intermediate subsidiary that purchases the issued liability is required to issue the liabilities necessary to meet the internal MREL requirement applicable to it, increased by the amount of such purchased liability. If the subsidiary is indirectly financed not by its parent company but, for example, by a regulated SPV that is also part of the resolution group, the deduction is still required.**

Once final EU-level legislation on the treatment of group financing is adopted, the MNB will review and, if necessary, adapt its methodology described above to the new legal framework.

# DEADLINE FOR THE COMPLIANCE WITH MREL REQUIREMENT

Following the amendment a deadline is set for compliance with MREL requirements. Pursuant to the provisions of the Act on Resolution, **institutions required to comply with MREL requirements must comply with the final MREL requirements continuously from 1 January 2024.** For Pillar 1 institutions, the deadline for compliance with the subordination requirement of 8% of the TLOF is the same as the deadline for compliance with the MREL requirements. Compliance with the Pillar 1 MREL TREA and MREL TEM statutory minimum requirements and related subordination requirements will be mandatory from 1 January 2022 for institutions subject to statutory objective criteria and for institutions subject to compliance based on a decision of the resolution authority (other Pillar 1 institutions) from 3 years after designation.

The MNB is also entitled to set a longer transitional period for compliance with the requirements than the final deadline set in the Act on Resolution, if the resource structure and financial situation of the institution concerned justify it and the institution will be able to comply with the requirements within a reasonable period of time.

Taking into account that the deadline set as a general rule is in line with the adaptation period granted by the MNB under the previous legal framework, exercising its flexible margin of discretion, the **MNB does not see any justification for a derogation from the statutory deadline for institutions that are currently operating**. In the case of newly established institutions, taking into account that the assessment can be carried out after the establishment, the MNB shall decide on an individual basis on the justification for granting a transitional period for compliance with the MREL requirement, taking into account the criteria set out in paragraphs (3) and (9) of Article 150/D of the Act on Resolution.

Given that institutions domiciled in Hungary are currently only required to comply with Pillar 1 requirements based on the decision of the resolution authority, and taking into account that other Pillar 1 institutions are expected to be designated in 2021, **these institutions will be required to comply with the minimum regulatory level of MREL TREA and MREL TEM requirements with subordinated liabilities from 3 years after their designation as other Pillar 1 institutions, at the earliest in 2024. The 3-year transitional period will start to run from the date on which the MNB's decision to classify an institution as a Pillar 1 institution is communicated to the institution.**

In order to achieve the final MREL requirements, the MNB will set an interim target level to be met from 1 January 2022 and will communicate the planned MREL level to the entities concerned for each 12-month period of the transitional period[[42]](#footnote-42). The interim or projected target levels for the transitional period should be set taking into account the gradual achievement of the MREL requirements on a steady path[[43]](#footnote-43). The MNB is entitled to adjust ex-post either the transitional period or the planned MREL levels for the transitional period[[44]](#footnote-44).

Taking into account that the first MREL requirements corresponding to the amendment will be imposed in 2021, the MNB does not impose a planned MREL level prior to the interim MREL target level to be met on 1 January 2022. **For the transitional period, the MNB will therefore set an interim target to be achieved as of 1 January 2022 and a planned MREL level for 1 January 2023. These target levels are set by the MNB with a view to achieving the final MREL requirement on a linear path.** Given the limited possibilities of institutions due to the short time available to adjust to the interim target from 1 January 2022 onwards to comply with the MREL requirement, the MNB will set the interim MREL target level at the end-2019 MREL level as reported in the institutions' latest year-end data. The projected MREL level for 1 January 2023 is more by half the amount resulting from the difference between the interim target and the final MREL requirement compared to the interim target level applicable from 1 January 2022.

When reviewing the MREL requirements, the MNB will also assess the appropriateness of the transitional period available to meet the requirements and the planned MREL levels, and the need for any changes to them.

# Limits on investments in MREL eligible instruments

The statutory conditions and restrictions on the retail sale of subordinated instruments eligible for write-down are detailed in Article 61/A of the Act on Resolution. The MNB, acting in its resolution function, considers that, within the framework of the existing general investor protection and consumer protection rules and its rules on the retail sale of subordinated instruments eligible for write-down, the MNB, in its consumer protection role, may ensure that potential investors have adequate information about the risks of these assets when making their investment decisions. Taking also into account that there are no restrictions on the retail sale of shares, the primary loss absorbing instrument, the MNB does not currently consider the retail investor's holding in MREL-eligible instruments to be an impediment to resolvability in general. **Therefore, the MNB does not consider it justified to exclude natural persons, micro, small and medium-sized enterprises from holding MREL eligible liabilities, or to set requirements for this that go beyond the legal requirements.**

At the same time, in the MNB’s opinion, credit institutions’ investments in MREL eligible liabilities of institutions not belonging to the same resolution group constitute a major source of contagion risk. If there is high probability that these MREL eligible instruments held by other institutions will be involved in loss absorption or bail-in, it may jeopardise financial stability through the spreading of the losses. Therefore, **during the resolvability assessment, direct investments in MREL-eligible instruments are continuously monitored by the MNB, in particular but not limited to instruments classified into the new class of ‘non-preferred senior debt’ created within the insolvency hierarchy of the insolvency proceedings pursuant to the Bank Creditor Hierarchy Directive. If an institution invests substantial amount in such instruments, or the portfolio of invested assets shows a high concentration of exposure to individual institutions, the MNB considers this as a potential impediments to resolvability, which justifies the imposition of an additional MREL requirement.**

1. Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms [↑](#footnote-ref-1)
2. Act XXXVII of 2014 on the Further Development of the System of Institutions Strengthening the Security of the Individual Players of the Financial Intermediary System. [↑](#footnote-ref-2)
3. Commission Delegated Regulation (EU) 2016/1450 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities [↑](#footnote-ref-3)
4. Section 63(56)b) of the Act on Resolution [↑](#footnote-ref-4)
5. Section 3(56)a) of the Act on Resolution [↑](#footnote-ref-5)
6. The credit institutions permanently affiliated to a central body and the central body itself, as well as their subsidiaries form a resolution group, if the resolution authority envisages the application of resolution action in the resolution plan of the group (at least one of them is a resolution entity). [↑](#footnote-ref-6)
7. Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges. [↑](#footnote-ref-7)
8. Groups under Article 10 of the CRR [↑](#footnote-ref-8)
9. Article 92(3) of the CRR [↑](#footnote-ref-9)
10. Section 62(2)a) of the Act on Resolution [↑](#footnote-ref-10)
11. Article 429(4) of the CRR [↑](#footnote-ref-11)
12. Section 62(2)b) of the Act on Resolution [↑](#footnote-ref-12)
13. The contribution from the Resolution Fund shall not exceed 5% of the total liabilities, including own funds, of the institution under resolution. [↑](#footnote-ref-13)
14. except Article 72b(2)(d) [↑](#footnote-ref-14)
15. For non-resolution entities, Article 72b(2)(b), (c), (k), (l) and (m) and Article 72b(3) to (5) shall not apply. [↑](#footnote-ref-15)
16. European Commission Delegated Regulation 2016/1075/EU [↑](#footnote-ref-16)
17. Section 58(1) of the Act on Resolution; Section 59(1)-(2) of the Act on Resolution; [↑](#footnote-ref-17)
18. Section 59(3) of the Act on Resolution [↑](#footnote-ref-18)
19. Section 67(14) of the Act on Resolution [↑](#footnote-ref-19)
20. With a subordinated instrument eligible for write-down or a liability under Article 66(6) of the Act on Resolution [↑](#footnote-ref-20)
21. Section 93(5) of the Credit Institutions Act [↑](#footnote-ref-21)
22. With own funds, subordinated instrument eligible for write-down or a liability under Article 66(6) of the Act on Resolution [↑](#footnote-ref-22)
23. Section 66(7) of the Act on Resolution [↑](#footnote-ref-23)
24. Section 1 of Annex 4 of the Act on Resolution [↑](#footnote-ref-24)
25. Section 66(13) and (14) of the Act on Resolution [↑](#footnote-ref-25)
26. Not to be avoided by means of measure in accordance with Article 12 of the Act on Resolution. [↑](#footnote-ref-26)
27. The institution falls within the highest risk quintile of all institutions subject to the MREL requirement for Pillar 2 capital requirements set by the Supervision) [↑](#footnote-ref-27)
28. Section 2 of Annex 4 of the Act on Resolution [↑](#footnote-ref-28)
29. Section 66(10) of the Act on Resolution [↑](#footnote-ref-29)
30. Section 3(1)a) of the Act on Resolution [↑](#footnote-ref-30)
31. Claims arising from deposits pursuant to Section 57 (1)(a) of the Credit Institutions Act shall be included in the satisfaction group following Section 57(1)(c) and preceding Section 57(1)(d) of the Bankruptcy Act, claims arising from deposits pursuant to Section 57 (1)(b) in the satisfaction group following Section (a) and preceding 57(1)(d) of the Bankruptcy Act and claims arising from deposits pursuant to Section 57 (1)(c) (other than those is Section (a) and (b)) in Section of the Bankruptcy Act 57(1)(d), while other liabilities to the institution shall be classified in Section 57(1)(f) of the Bankruptcy Act. [↑](#footnote-ref-31)
32. Section 66(6) of the Act on Resolution [↑](#footnote-ref-32)
33. Groups under Article 10 of the CRR [↑](#footnote-ref-33)
34. Section 3(56a)b) of the Act on Resolution [↑](#footnote-ref-34)
35. Section 68/A(3) of the Act on Resolution [↑](#footnote-ref-35)
36. Article 7(2) [↑](#footnote-ref-36)
37. The relevant legislation distinguishes three types of subordination: statutory, contractual and structural. [↑](#footnote-ref-37)
38. Article 2 (1) (a) of Directive 2002/47/EC by means of a financial collateral arrangement [↑](#footnote-ref-38)
39. Article 197 of the CRR [↑](#footnote-ref-39)
40. <https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2020/EBA/CP/2020/18/897737/EBA-CP-2020-18%20Draft%20RTS%20on%20daisy%20chains%20of%20internal%20MREL.pdf> [↑](#footnote-ref-40)
41. **Holding-based approach**. A possible alternative could be a regulatory-based approach, whereby only the internal MREL element corresponding to the loss absorbing amount (LAA) and recapitalisation amount (RCA) of the institution (Subsidiary 2) would be deducted from the internal MREL requirement of the intermediate subsidiary. The method used by the MNB reflects a more conservative approach, as in the case of a potential loss, the loss-liability (write-down or conversion of liabilities) is not limited to the MREL-eligible part of the liability, the potential exposure of the intermediate subsidiary is the total financing, therefore, it has to issue so much more internal MREL to cover its own losses. [↑](#footnote-ref-41)
42. Section 150/D(1) and (8) of the Resolution Act [↑](#footnote-ref-42)
43. Section 150/D(2) of the Resolution Act [↑](#footnote-ref-43)
44. Section 150/D(10) of the Resolution Act [↑](#footnote-ref-44)