FINANSTILSYNET

MEMO

Danish Financial Supervisory Authority

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Reaction pattern following breach of MREL

The Danish FSA's priority for distressed banks is a private solution in the form of a capital injection, sale of assets/branches, merger with a stronger institution, or similar. If a private solution cannot be found, the FSA will be obliged to transfer the bank to Finansiel Stabilitet.

Where a bank is in breach of its MREL, including the regulatory capital buffers, the FSA will always undertake a specific, individual assessment of the consequences the breach should have. Where necessary, the FSA may transfer control to Finansiel Stabilitet if a bank does not comply with its MREL.

The FSA's initial reaction to a breach of a bank's MREL will, as a starting point, be to set a deadline for complying with the requirement, which will be determined on the basis of the nature of the case and the specific circumstances. The aim here is for the bank to take action within the given deadline so that, depending on the health of the bank, it either returns to compliance with its MREL (through the injection of new capital or sale of entities/assets) or merges with a stronger partner. Under the rules on early intervention, the FSA may therefore instruct a bank that is in breach of its MREL to contact potential buyers with a view to preparing a merger. In other words, the aim is to avoid transferring control to Finansiel Stabilitet.

Each bank's MREL is set in accordance with the preferred resolution strategy in the bank's resolution plan. If the bank is in breach of its MREL when resolution begins, the situation may be harder to manage. The size of the MREL shortfall and developments in this shortfall will therefore be a key factor when the FSA sets the deadline.

The prospects of finding a merger partner – or another private solution – will be a second key factor in the FSA's assessment. If, for example, there are multiple potential buyers showing an interest that the FSA considers to be realistic, this will be a positive factor in the FSA's assessment of the likelihood of avoiding resolution.

In principle, a bank will be able to work its way down through its capital buffers without a transfer of control. All possibilities for recovery must, however, be explored when a bank breaches its capital buffer requirements, i.e. breaches its MREL. When a bank's MREL qualifying own funds and eligible liabilities fall below its solvency need plus the loss absorption and recapitalisation add-ons, the FSA will, taking account of actions already taken, assess whether there is a need to transfer control of the bank to Finansiel Stabilitet. If a bank's MREL qualifying own funds and eligible liabilities fall below its solvency need plus loss absorption add-on, this assessment will be more acute. In both situations, control will be transferred to Finansiel Stabilitet only once other solutions have been exhausted or are not considered viable.

Where a bank is in breach of its MREL (excluding capital buffers) and has MREL instruments with a final maturity date, the FSA will endeavour to ensure, with respect for proportionality, that no creditors are disadvantaged by the maturity of these instruments.