Evaluating AT1 securities becomes more complex

The latest addendum to the Single Resolution Board's 2018 MREL policy contains two items of interest for AT1 investors. The first is an obligation to request SRB approval for early repayment of eligible liability instruments, which potentially raises call risk for AT1 securities. The second concerns the parallel MREL and TLAC requirements to which EU-based G-SIIs are subject.

Most EU-based global systemically important institutions (G-SIIs) are currently comfortably positioned against total loss-absorbing capacity (TLAC) requirements and the binding SRB Minimum Requirement for own funds and Eligible Liabilities (MREL) decisions set last year, based on end-2016 balance sheets. But this may change as requirements evolve. As highlighted in our note from April, "EU banking package brings new risks for AT1 investors", a new MREL-related MDA will be coming into place at the end of 2020.

With the amendments to Regulation (EU) 575/2013 (CRR) applicable from 27 June 2019, the SRB published an addendum to its 2018 MREL policy for more complex banks. The update concerns CRR provisions relating to TLAC for G-SIIs and the permissions regime which applies to all institutions.

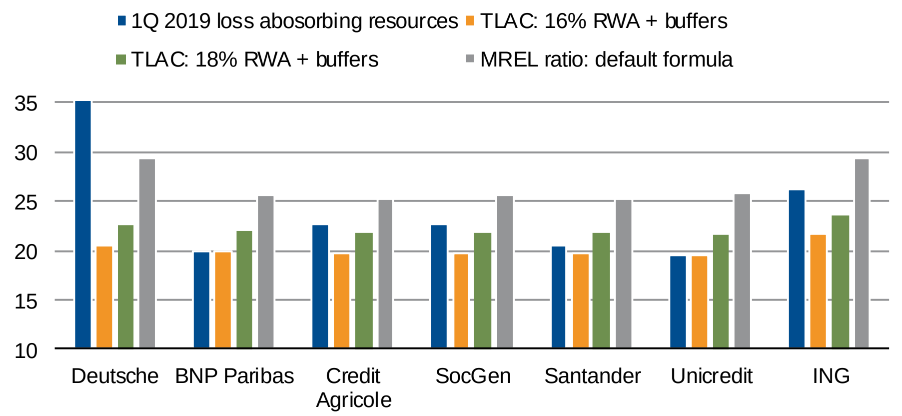
When the AT1 market began about six years ago, investors could focus on an issuer's CET1 capital position compared to the write-down/conversion trigger and the required level to avoid calculating the maximum distributable amount (MDA). This is evolving to a point where investors will need to evaluate whether a bank is meeting various solvency requirements such as leverage and MREL, and not just CET1 capital.

Interplay between TLAC requirements and SRB MREL decisions

Amendments to the BRRD and the new MREL framework will not be in place until 28 December 2020. Consequently, the SRB will continue to set MREL decisions for more complex banks according to its "2018 MREL policy for the second wave of resolution plans" published in January 2019. The default formula is comprised of a loss absorption amount and a recapitalisation amount. In effect, two times Pillar 1 and Pillar 2 requirements plus two times the combined buffer requirement minus 1.25%.

By the beginning of 2020, the SRB intends to publish its "2020 MREL policy" which will be used for MREL-setting under the new BRRD framework. In the meantime, EU-based G-SIIs must also meet the TLAC requirements now included in CRR.

Figure 1: EU G-SIIs: loss-absorbing resources vs. TLAC and MREL



Note: Loss absorbing resources of UniCredit includes 2.5% of preferred senior debt.
Source: Banks, Scope Ratings

Analysts

Pauline Lambert
p.lambert@scoperatings.com

Alessandro Boratti
a.boratti@scoperatings.com

Team leader

Dierk Brandenburg
d.brandenburg@scoperatings.com

Related Research

EU banking package brings new risks for AT1 investors
April 2019

Scope Ratings GmbH

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

EU G-SIIs subject to both TLAC and MREL in parallel

Until the amended BRRD legal framework is in place, resolution entities of EU G-SIIs and material subsidiaries of EU G-SIIs headquartered in a third country will be subject to CRR statutory TLAC and internal TLAC requirements as well as binding SRB MREL decisions in parallel.

In line with the Financial Stability Board's (FSB) TLAC standards, EU resolution entities that are G-SIIs or part of a G-SII must meet the following:

- From 27 June 2019 until 31 December 2021, an external TLAC requirement of 16% of total risk exposure amount (TREA) and 6% of leverage ratio exposure measure (LREM), calculated on a consolidated basis at resolution group level, and
- From 1 January 2022, 18% of TREA and 6.75% of LREM.

2.5% allowance for senior preferred debt under review

Requirements must be met with subordinated liabilities. However, the SRB may grant an allowance for senior instruments used for external TLAC – up to 2.5% of TREA until 31 December 2021 and up to 3.5% of TREA from 1 January 2022. There may also be an allowance when senior instruments ranking pari passu or lower than excluded liabilities are less than 5% of the institution's own funds and eligible liabilities.

In both cases, the SRB will only grant the allowance if there is no material risk of a challenge under the no creditor worse off (NCWO) principle. Under transitional CRR provisions, G-SIIs benefit from the 2.5% senior instruments allowance until the SRB has made the above assessment.

Improved disclosure on the way

Helpfully for investors, under CRR, G-SIIs must disclose their TLAC capacity on a quarterly basis. Further information on the composition of owns funds and eligible liabilities, their maturity and main features, the amount of issuance included in the senior allowance, the amount of excluded liabilities, and the ranking of eligible liabilities in the creditor hierarchy must be disclosed semi-annually.

Situation for Swiss and UK banks is not the same

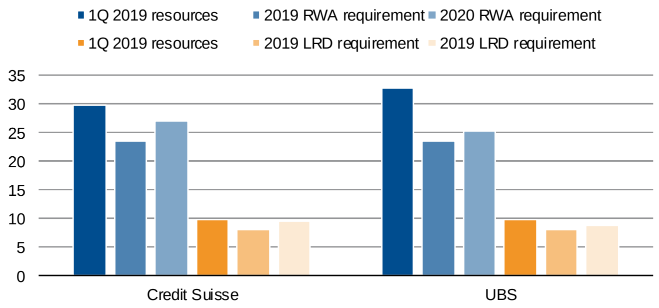
Systemically-relevant Swiss banks are not bound by CRD IV but instead are subject to the Swiss TLAC framework, both on an RWA and leverage basis. Going concern requirements are 14.3% of RWA and 5% of the leverage ratio denominator (LRD), of which at least 3.5% must be CET1 capital. Meanwhile, gone-concern requirements are also 14.3% of RWA and 5% of LRD, although they may be reduced if a bank takes additional steps beyond the minimum to improve its resolvability.

MREL/TLAC requirements for UK G-SIBs are already harmonised

For UK banks, the Bank of England has set MREL to implement TLAC and therefore, the banks do not face separate requirements. MREL is being phased in as follows:

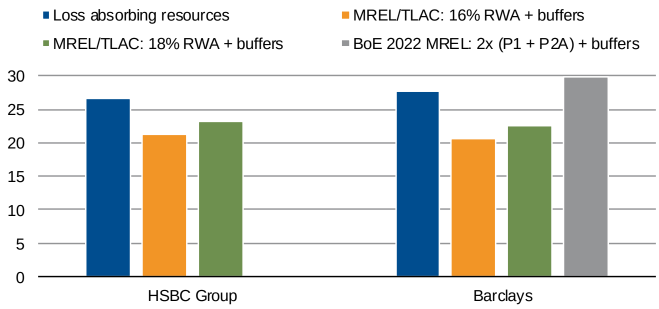
- From 1 January 2019, UK resolution entities that are G-SIBs are required to meet the minimum requirements of the FSB TLAC standard – the higher of 16% of RWAs or 6% of leverage exposures.
- From 1 January 2020, the higher of two times Pillar 1 requirements and one time Pillar 2A add-ons; or if subject to a leverage ratio requirement, two times the applicable requirement.
- From 1 January 2022, the higher of: (i) two times the sum of Pillar 1 and Pillar 2A requirements or; (ii) the higher of two times the applicable leverage ratio requirement or 6.75% of leverage exposures (in line with the FSB TLAC standard). However, the MREL calibration is subject to review by end-2020.

Figure 2: Swiss G-SIIBs



Note: LRD = leverage ratio denominator. Requirements include rebates/reductions granted by FINMA.
Source: Banks, Scope Ratings

Figure 3: UK G-SIIBs



Notes: For HSBC, loss absorbing resources are as of YE 2018 while for Barclays, they are as of 1Q 2019. With a preferred multiple point of entry resolution strategy, HSBC Group expects sum-of-the-parts to be the binding constraint rather than group MREL/TLAC.
Source: Banks, Scope Ratings

Details on new SRB approval process

SRB approval is in addition to ECB approval

As of 27 June 2019, EU G-SIIs and other institutions with MREL decisions higher than the loss-absorption amount must seek approval from the SRB to call, redeem, or repurchase eligible liabilities instruments before their contractual maturities. This is in addition to the approval needed from competent authorities (e.g. the ECB). With approvals now required by two separate regulatory authorities, this potentially increases the call risk for AT1 securities.

Approval can be given on an instrument-by-instrument basis or on a general permissions basis, where the institution has approval for a pre-determined amount and for a period not exceeding one year. General permissions can be renewed.

Applications must be submitted at least four months in advance

Until the EBA drafts regulatory technical standards and the regulations are in effect, the SRB has detailed a provisional procedure which includes the following:

- Applications for approval must be made at least four months in advance.
- Information on MREL plans for at least the next three years should be included in the application, focusing on the level of eligible liabilities before and after the redemptions and the impact of redemptions on MREL requirements.
- When replacing eligible liability instruments, information on the cost of the replacement instrument and the impact of the replacement on the sustainability of the institution's profitability should also be included.

Appendix I:

Headroom to MDA relevant CET1 requirements

		2019	2018	1Q 2019			
	Basis	Requirement	YE CET1	CET1	Gap %	Currency	Gap bn
Barclays	Transitional	11.7%	13.2%	13.0%	1.3%	GBP	2.9
BBVA	Transitional	9.3%	11.6%	11.6%	2.3%	EUR	8.4
BNP Paribas	Transitional	9.9%	11.8%	11.7%	1.8%	EUR	11.7
Commerzbank	Transitional	10.1%	12.9%	12.7%	2.6%	EUR	4.8
Credit Agricole Group	Transitional	9.7%	15.0%	15.2%	5.5%	EUR	30.4
Credit Agricole SA	Transitional	8.5%	11.5%	11.5%	3.0%	EUR	9.6
Credit Suisse Group	Transitional	9.7%	12.5%	12.5%	2.8%	CHF	37.2
Danske Bank	Transitional	11.3%	17.0%	16.7%	5.4%	DKK	40.7
Deutsche Bank	Transitional	11.8%	13.6%	13.7%	1.9%	EUR	6.6
DNB Group	Transitional	14.0%	16.4%	16.4%	2.4%	NOK	26.0
HSBC	Transitional	11.4%	14.0%	14.3%	2.9%	USD	25.5
ING Group	Transitional	11.8%	14.5%	14.7%	2.9%	EUR	9.0
Intesa	Transitional	9.0%	13.5%	13.1%	4.2%	EUR	11.8
KBC Group	Transitional	10.4%	16.0%	15.7%	5.3%	EUR	5.1
Lloyds	Transitional	12.3%	14.6%	13.9%	1.6%	GBP	3.3
Nordea Bank	Fully loaded	11.1%	15.5%	14.6%	3.5%	EUR	5.7
Rabobank Group	Transitional	11.8%	16.0%	16.0%	4.3%	EUR	8.6
RBS Group	Transitional	10.7%	16.2%	16.2%	5.5%	GBP	10.5
Santander	Transitional	9.7%	11.5%	11.2%	1.5%	EUR	9.3
Societe Generale	Transitional	10.0%	11.0%	11.5%	1.5%	EUR	5.6
Svenska Handelsbanken	Fully loaded	11.5%	16.8%	16.4%	4.9%	SEK	36.1
Swedbank	Fully loaded	11.6%	16.3%	15.9%	4.3%	SEK	28.4
UBS Group	Transitional	9.7%	13.1%	13.0%	3.3%	CHF	36.2
UniCredit	Transitional	10.1%	12.1%	12.3%	2.2%	EUR	8.2

Notes: Nordea is not expected to receive its SREP from the ECB until 1Q 2020. For Nordea, Handelsbanken, Swedbank, DNB and Danske, Pillar 2 requirements are excluded from 2019 MDA-relevant CET1 requirements.
Source: Banks, Scope Ratings

Appendix II:

Headroom to writedown/conversion trigger

			2018		1Q 2019	
	Basis	Trigger	YE CET1	4Q18Gap %	CET1	Gap %
Barclays	Fully loaded	7.00%	12.8%	5.8%	12.6%	5.6%
BBVA	Transitional	5.125%	11.6%	6.4%	11.6%	6.5%
BNP Paribas	Transitional	5.125%	11.8%	6.7%	11.7%	6.6%
Commerzbank	Transitional	5.125%	12.9%	7.7%	12.7%	7.6%
Credit Agricole Group	Transitional	7.00%	15.0%	8.0%	15.2%	8.2%
Credit Agricole SA	Transitional	5.125%	11.5%	6.4%	11.5%	6.4%
Credit Suisse Group	Transitional	7.00%	12.5%	5.5%	12.5%	5.5%
Danske Bank	Transitional	7.00%	17.0%	10.0%	16.7%	9.7%
Deutsche Bank	Transitional	5.125%	13.6%	8.4%	13.7%	8.6%
DNB Group	Transitional	5.125%	16.4%	11.3%	16.4%	11.3%
HSBC	Fully loaded	7.00%	13.9%	6.9%	14.2%	7.2%
ING Group	Transitional	7.00%	14.5%	7.5%	14.7%	7.7%
Intesa	Transitional	5.125%	13.5%	8.3%	13.1%	8.0%
KBC Group	Transitional	5.125%	16.0%	10.8%	15.7%	10.5%
Lloyds	Fully loaded	7.00%	14.3%	7.3%	13.6%	6.6%
Nordea Bank	Fully loaded	8.00%	15.5%	7.5%	14.6%	6.6%
Rabobank Group	Transitional	7.00%	16.0%	9.0%	16.0%	9.0%
RBS Group	Fully loaded	7.00%	16.2%	9.2%	16.2%	9.2%
Santander	Transitional	5.125%	11.5%	6.3%	11.2%	6.1%
Societe Generale	Transitional	5.125%	11.0%	5.9%	11.5%	6.4%
Svenska Handelsbanken	Fully loaded	8.00%	16.8%	8.8%	16.4%	8.4%
Swedbank	Fully loaded	8.00%	16.3%	8.3%	15.9%	7.9%
UBS Group	Transitional	7.00%	13.1%	6.1%	13.0%	6.0%
UniCredit	Transitional	5.125%	12.1%	7.0%	12.3%	7.1%

Source: Banks, Scope Ratings

Appendix III:

Selected issues with call dates in 2019-2020

Issuer	Amount	Coupon %	Issue Date	Next call date	Reset Spread %	Reference swap	Conversion type	Trigger %
Banco Santander SA	1,500,000,000	6.25	12/03/2014	12/09/2019	5.41	EUAMDB05	Equity conversion	5.125
Barclays PLC	1,211,446,000	6.625	17/06/2014	15/09/2019	5.02	USSW5	Equity conversion	7
Barclays PLC	697,602,000	7	17/06/2014	15/09/2019	5.08	BPSW5	Equity conversion	7
Barclays PLC	1,076,730,000	6.5	17/06/2014	15/09/2019	5.88	EUSA5	Equity conversion	7
Credit Agricole SA	1,250,000,000	6.625	18/09/2014	23/09/2019	4.697	USSW5	Temporary write down	5.125
Nordea Bank AB	1,000,000,000	5.5	23/09/2014	23/09/2019	3.563	USISDA05	Temporary write down	5.125
HSBC Holdings PLC	1,500,000,000	5.625	17/09/2014	17/01/2020	3.626	USISDA05	Equity conversion	7
Societe Generale	1,500,000,000	6	25/06/2014	27/01/2020	4.067	USSW5	Temporary write down	5.125
BBVA	1,500,000,000	6.75	18/02/2015	18/02/2020	6.608	EUSA5	Equity conversion	5.125
UBS Group Funding AG	1,250,000,000	7.125	19/02/2015	19/02/2020	5.464	USSW5	Permanent write down	7
DNB Bank ASA	2,150,000,000	3M Nibor + 325	26/02/2015	26/02/2020	3.25	NIBOR3M	Temporary write down	5.125
Nordea Bank AB	2,250,000,000	2.61	12/03/2015	12/03/2020	3.1	STIB3M	Temporary write down	5.125
Swedbank	750,000,000	5.5	19/02/2015	17/03/2020	3.767	USSW5	Equity conversion	5.125
DNB Bank ASA	750,000,000	5.75	26/03/2015	26/03/2020	4.075	USSW5	Temporary write down	5.125
Standard Chartered	2,000,000,000	6.5	02/04/2015	02/04/2020	4.889	USSW5	Equity conversion	7
Danske Bank A/S	750,000,000	5.75	12/03/2014	06/04/2020	4.64	EUSA6	Temporary write down	7
Deutsche Bank AG	1,250,000,000	6.25	27/05/2014	30/04/2020	4.358	USSW5	Temporary write down	5.125
SEB	1,100,000,000	5.75	13/11/2014	13/05/2020	3.85	USSW5	Temporary write down	5.125
Bank of Ireland	750,000,000	7.375	18/06/2015	18/06/2020	6.956	EUSA5	Temporary write down	5.125
Lloyds Banking Group PLC	750,000,000	6.375	01/04/2014	27/06/2020	5.29	EUSA5	Equity conversion	7
Rabobank Nederland	1,500,000,000	5.5	22/01/2015	29/06/2020	5.25	EUSA5	Temporary write down	5.125
UniCredit SpA	500,000,000	9.375	21/07/2010	21/07/2020	7.49	EUR003M	Temporary write down	6
RBS Group PLC	2,000,000,000	7.5	10/08/2015	10/08/2020	5.8	USSW5	Equity conversion	7
ABN AMRO	1,000,000,000	5.75	22/09/2015	22/09/2020	5.452	EUSA5	Temporary write down	5.125
Barclays PLC	1,000,000,000	8	10/12/2013	15/12/2020	6.75	EUSA5	Equity conversion	7

Source: Banks, Scope Ratings

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

London
Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

Disclaimer