Norwegian banks: adoption of EU Creditor Hierarchy Directive facilitates MREL issuance

Upcoming adoption of the EU Creditor Hierarchy Directive will allow Norwegian banks to issue senior non-preferred debt on a statutory basis for the first time. The country's banking supervisor has consistently said there is a basis for most banks in Norway to be subject to an MREL requirement.

From 1 July 2021, new rules clarifying the ranking of creditors in insolvency enter into force in Norway. EU Directive 2017/2399 (Creditor Hierarchy Directive), which amends the ranking of debt instruments in insolvency under the Bank Recovery and Resolution Directive (BRRD), is being transposed into Norwegian law. This aligns Norwegian law with EU law and follows the adoption of BRRD in Norway in 2019. Among other things, this clarified the ranking of bank deposits.

The Creditor Hierarchy Directive introduces into Norway a new class of statutory senior non-preferred debt that ranks in insolvency above subordinated debt and equity, but below other senior liabilities. Due to its ranking, senior non-preferred debt can be used to meet MREL requirements. Norwegian banks have so far issued senior non-preferred debt on a contractual basis.

Figure 1: Updated creditor hierarchy

Guaranteed deposits	
Non-guaranteed deposits (individuals and SMEs)	
Deposits (wholesale and institutional)	Senior preferred debt
Senior non-preferred debt	
Subordinated debt	
Tier 2 securities	
AT1 securities	
Equity	

Source: Scope Ratings.

Adopting EU rules into Norwegian law

Norway is not part of the EU but of the European Economic Area (EEA). Relevant EU rules are normally incorporated into the EEA Agreement before being enacted into Norwegian law. Consequently, there may be a time lag for implementation.

For example, the EU banking package incorporating amendments to BRRD and the Capital Requirements Directive and Regulation (CRR2, CRD5 and BRRD2) has yet to be incorporated into the EEA Agreement. The deadline for the national transposition of CRD5 and BRRD2 in the EU was 28 December 2020 while the main tenets of CRR2 will apply in the EU from 28 June 2021.

Following a public consultation in October 2020, a legislative proposal for implementing the EU banking package was submitted to the Norwegian Parliament in April 2021. The earliest possible implementation date would be in the third quarter of 2021 although it could be later.

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MREL requirements for largest Norwegian banks

To date, the Norwegian Financial Supervisory Authority (NFSA) has set MREL requirements for 14 of the largest banks. Eight received their first requirements in 2019 and the remainder last year. The first group of banks subsequently received updated requirements in December 2020.

MREL set as a % of adjusted RWAs

Requirements are set as a percentage of adjusted risk-weighted assets (RWAs). The adjusted RWA figure reflects the exemption of covered bond companies from MREL requirements. Assets related to wholly or partly-owned covered bond companies are deducted, but liabilities such as credit lines or liquidity facilities are included. Adjusted RWA figures would normally be lower than reported ones.

The standard MREL requirement is comprised of a loss absorption amount equal to Pillar 1 + Pillar 2 + all buffers, and a recapitalisation amount equal to Pillar 1 + Pillar 2 + all buffers except the countercyclical buffer.

Figure 1: Total assets and MREL requirements

	Total assets (NOK bn)	MREL requirement % Adjusted RWAs
DNB	2,989.2	35.54%
SpareBank 1 SR-Bank	296.5	34.40%
Sparebanken Vest	216.1	34.40%
SpareBank 1 SMN	193.8	34.80%
SpareBank 1 Ostlandet	150.1	34.60%
Sparebanken Sor	139.0	32.00%
SpareBank 1 Nord-Norge	118.8	34.00%
Sbanken	101.7	31.00%
Sparebanken More	81.1	31.40%
Sparebanken Sogn og Fjordane	63.9	31.40%
Norwegian Finans Holding	59.5	39.02%
OBOS Finans Holding	50.6	32.80%
Sparebanken Ost	46.4	31.60%
SpareBank 1 BV	40.9	31.80%

Notes: Total assets as of 31 March 2021 except for OBOS Finans Holding which is as of 31 December 2020. Requirements as of December 2020. Source: SNL, NFSA, Scope Ratings.

Requirements for subordination

Currently full subordination required

Norwegian banks are required to fulfill the full recapitalisation component of MREL with subordinated liabilities (i.e. non-preferred senior debt and capital). Last year, due to the market disruption caused by the pandemic, the NFSA postponed the deadline for compliance to 1 January 2024 from 31 December 2022. The new deadline is in line with BRRD2. Further, senior preferred debt with a minimum remaining tenor of one-year qualities as MREL until 1 January 2024.

The EU banking package introduces a new framework for setting subordination requirements based on a bank's size and systemic importance as well as the "no creditor worse off" (NCWO) principle. The level of subordination should be at least equal to 8% of total liabilities and own funds (TLOF). This is capped at 27% of risk exposures for banks with more than EUR 100bn in total assets (deemed to be Top Tier Banks).

Other banks not considered to be Pillar 1 banks (i.e. G-SIIs, Top Tier, or other systemic) will be subject to a subordination requirement only if needed to avoid a breach of the NCWO principle.

A cap on subordination may be introduced

There is still some uncertainty about the level of subordination that will be required in Norway. With a cap on the level of subordination, banks such as DNB and Sparebanken Vest have indicated that this could reduce the amount of required senior non-preferred debt by 40%-50%.

MREL for other banks remains a pending issue

MREL requirements for other Norwegian banks seems likely

The NFSA has consistently said there is a basis for most Norwegian banks to be subject to an MREL requirement. Banks which are not designated as systemic may still be important to a particular region or a specific customer group. In addition, problems with one or more small or medium-sized banks may have contagion effects and reduce confidence in the banking system.

At the same time, the NFSA has acknowledged that the calibration of MREL may need to be adapted and the ability of a bank to issue senior non-preferred debt may need to be considered when determining the timeframe for compliance. We note that many smaller Norwegian banks already issue in the capital markets, including Tier 2 and AT1 securities, which is not the case across Europe.

A subject of discussion at the EU level also

Within the EU, the debate has been focused on the ability of banks to issue MREL liabilities as well as the funding needed for the orderly management of bank failures. The Single Resolution Board (SRB) covers about 130 banking groups considered to be significant institutions out of more than 3,000 banks across the Banking Union. Yet, many of these are not listed and have never issued contingent convertible instruments.

Growing focus on managing potential failures of smaller banks

There is a growing focus on addressing the challenges associated with small and medium-sized banks financed mostly by capital and deposits. The most suitable crisis management strategy for these may be a sale or transfer under resolution or insolvency. This would require sufficient MREL or other funding such as from a deposit guarantee scheme to execute.

The other area of discussion is the need for more harmonised bank insolvency procedures across the EU. Some of the benefits include strengthening the Banking Union, facilitating the resolution planning of cross-border banking groups, and providing investors with the same level of clarity in resolution and liquidation.

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