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FMA Communication 2022/02 – Determination of the minimum requirement for own funds and eligible liabilities (“MREL Policy”)

Communication on the determination of the minimum requirement for own funds and eligible liabilities (“MREL”) and corresponding resolution planning interlinkages for banks and investment firms (“MREL Policy”).

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Annexes:	*only in German Version*

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1. Introduction

Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC ("**BRRD II**"; OJ [EU] 2019 L 150 of 7 June 2019, p. 253 et seq.) will be implemented via RRA ("SAG") in Liechtenstein in 2023.

In order to enhance the resolvability of institutions and other relevant entities, any institutions for which there is a public interest in resolution in the event of a crisis shall maintain sufficient funds for loss-absorption and recapitalisation purposes. The aim of this is first of all to give effect to the principle of resolution that losses are always (or shall always be) borne in the first instance by the shareholders of the Institution under resolution.[1] It is also necessary to ensure that so-called "bail-in instruments" or transfer strategies can be successfully applied. "MREL" requirements, i.e. minimum requirements for own funds and eligible liabilities, are thus of central importance in regulatory terms for the resolution regime.

The MREL shall equal an amount sufficient to ensure at all times (Article 58b(1) and (2) RRA) that:

1. the losses that are expected to be incurred by the entity are fully absorbed ("loss absorption"); and
2. the resolution entity and its subsidiaries are recapitalised to a level necessary to enable them to continue to comply with the conditions for authorisation, and to carry on the activities for which they are authorised under financial markets law or an equivalent legislative act for an appropriate period not longer than one year ("recapitalisation").

The resolution authority established within the FMA Liechtenstein is competent to set the MREL (Article 3(1)(5) in conjunction with Article 58b(1) RRA). The MREL is set by the resolution authority after consulting with the FMA (in its capacity as the competent banking supervisory authority) (Article 58b(1) RRA).

FMA Communications are not legally binding. The position is determined by the relevant applicable legislation. The resolution authority expects entities to give due consideration to the Single Rule Book: https://eba.europa.eu/single-rule-book-qa.

2. Purpose of the "MREL Policy"

This FMA Communication ("MREL Policy") sets out transparently the mechanism for calibrating MREL used by the resolution authority for the purpose of increasing legal certainty in the Liechtenstein financial market. Although the resolution authority applies European practices and standards as a main guidance, in order to reduce complexity the authorities disclosure is limited to the relevant scenarios in Liechtenstein, for instance the single point of entry (SPE) for (cross-border) resolution groups. The Communication ("Policy") does not contain any further statements, such as concerning G-SRI, so-called "top tier banks", cooperative banks and/or deposit guarantee schemes.

The aim of the Communication is to enable affected entities to calculate the expected MREL themselves and to incorporate it efficiently into their overall bank management. This documentation is also intended as a disclosure to other financial market participants and stakeholders. In order to avoid misaligned incentives, the resolution authority engages in intense dialogue with affected entities and also carries out random checks during the course of the year concerning the figures and/or variables used (also known as "window dressing").

Where necessary in specific individual cases, the resolution authority reserves the right to depart from the position set out in this Communication, insofar as compatible with its statutory and legal competences.

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[1] This is apparent in particular from the statutory duty for the resolution authority first to write down and convert capital instruments and eligible liabilities pursuant to Article 78(3) in conjunction with Article 49(2) RRA ("WDC") before it is allowed to adopt resolution actions, e.g. the implementation of transfer strategies.

3. Definitions

The terms used in the Communication follow the definitions contained in the RRA, including in particular those listed in Article 3 RRA. In addition, the following definitions and abbreviations apply for the purposes of this Communication:

- "Resolution Entity": a resolution entity according to Article 3(5a) RRA; this is defined in the resolution plan (e.g. parent company of a banking group)
- "Resolution Group": a resolution group according to Article 3(5b) RRA; this is defined in the resolution plan and may, but need not, coincide with the consolidated situation according to the Article CRR[2] or a subconsolidated situation according to Article 22(2) CRR (e.g. subgroup)
- "Resolution Strategy": a package of resolution activities for the resolution of an entity or group
- "ASF": available stable funding
- "BSD_{TREA}": balance sheet depletion for the purpose of adjusting the RCA, expressed as a proportion of TREA
- "BSD_{LRE}": balance sheet depletion for the purpose of adjusting the RCA, expressed as a proportion of LRE
- "CBR": combined buffer requirement according to Article 4a(2) of the Liechtenstein Banking Act of 21 October 1992 (*Bankengesetz vom 21. Oktober 1992*; *BankG*, hereinafter referred to as the "BA")
- "$CBR_{\%TREA}$": combined buffer requirement according to Article 4a(2) BA, in % TREA)
- "CCP": central counterparty
- "CCyB": countercyclical capital buffer according to Article 4c BA
- "$CCyB_{\%TREA}$ ": countercyclical capital buffer according to Article 4c BA (in % TREA)
- "CSD": central securities depository
- "Equi∆": contribution made by the surplus or deficit of subordinated instruments to achieving equilibrium as part of the NCWO assessment
- "LAA": loss absorption amount
- "LCD": liquidity to covered deposits (in %)
- "LRE": leverage ratio exposure
- "LRR": leverage ratio requirement (in % LRE)
- "Subordinated Eligible Instruments": instruments that fulfil the conditions laid down by Article 72a CRR, except Article 72b(3) to (5) CRR
- "MCC": market confidence charge according to Article 58b(8) RRA (in % TREA)
- "M-MDA": maximum distributable amount related to MREL
- "MREL": minimum requirements on own funds and eligible liabilities
- "$MREL_{LRE}$": MREL in the leverage-based dimension (in % LRE)
- "$MREL_{TREA}$": MREL in der risk-based dimension (in % TREA)
- "$MV_{post\text{-}resolution}$": market value of newly issued shares following recapitalisation (in %)
- "NPE": non-performing exposures
- "NSFR": net stable funding ratio according to Article 428b CRR (in %)
- "P1R": pillar 1 requirement (8% TREA, 3% LRE)
- "P2R": pillar 2 requirement (e.g. 1% TREA)
- "RCA": recapitalisation amount
- "RSF": required stable funding
- "SAR": separability analysis report
- "SPE": single point of entry refers to a Resolution Strategy (or an option within the scope of a Resolution Strategy) whereby the resolution powers of a single resolution authority are exercised at the level of a single parent company or a single Institution that is subject to supervision at the level of a Resolution Group (e.g. parent company of a banking group)

[2] Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 646/2012 (OJ L 176, 27.6.2013, p. 1–337), as amended from time to time.

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- "$Strat_{Transfer}$": variable for reducing RCA according to a transfer strategy in relation to the exercise of transfer powers (Article 3(1)(102) RRA) or the taking of comparable action by the resolution authority
- "T_CREA": total credit risk exposure amount
- "TELOF" total eligible liabilities including own funds
- "TLOF": total liabilities including own funds
- "TSLOF": total subordinated liabilities including own funds
- "$TSLOF_{min}$": amount of the subordination requirement: the minimum amount of subordinated instruments (TSLOF) necessary in order to avoid leaving creditors worse off under a resolution scenario – compared to a liquidation scenario – as part of the NCWO assessment for the purpose of calibrating the subordination requirement.
- "$TSLOF_{TREAmin}$": $TSLOF_{min}$ as a proportion of TREA (in %)
- "TREA": total risk exposure amount
- "TSCR": total SREP capital requirement (P1R plus P2R; in % TREA)
- "WDC": write-down or conversion of shares and/or eligible liabilities according to Article 78 RRA

A mapping of reporting positions can be found in Annex III to this Communication (*only German Version*).

4. Framework conditions

Compared to those of other European countries, Liechtenstein's banking sector is characterised by some specific characteristics, which the resolution authority takes into account in this MREL Policy. One important specificity concerns the capitalization (CET1), which is above average by European standards: Whilst this Policy was being drawn up, this ratio amounted to more than 20% for all systemically important Institutions. In addition, the resolution authority recognises the stable ownership structure of these banking groups. The resolution authority stresses these aspects in this Policy, especially in reducing the misaligned incentives that can potentially arise due to the imposition of regulatory MREL requirements.

Usually, a high level of CET1 (according to a "going concern" perspective) is not an entirely acceptable substitute for other capital instruments that may be drawn upon during the course of a "bail-in" in the event of resolution for the purpose of recapitalisation. Owners with broadly diversified portfolios may potentially have an incentive for the Institution to take higher risks, where this may result in a higher anticipated return. In the event of the failure of the entity the losses are generally offset by the higher potential for success of this strategy amongst other entities or holdings in the portfolio. On the other hand, lenders (e.g. bondholders) are subject to different incentives: they have an interest in ensuring that the entity takes as little risk as possible as they could potentially suffer high losses in the event of liquidation, whilst not benefiting from the upside risk under this strategy. Due to market discipline, a higher risk appetite generally correlates with higher returns for bonds, which also entails higher funding costs for the Institution.

The structural differences in incentives for equity investors and lenders are not, or at most only marginally, present in Liechtenstein. This is due to the stable and overwhelmingly domestic ownership of the three systemically important banks. For all three groups, the main shareholder's stake represents a cluster risk for that shareholder, in the sense that a large proportion of the shareholder's assets is invested in the Institution. This results in different incentives from the perspective of shareholders: although shareholders could still potentially benefit from a high-risk strategy as a result of higher anticipated returns, they would also bear a major share of the costs were the strategy to fail and cause losses.

If these special framework conditions were to be disregarded, this would result in higher costs for banks as a result of additional MREL requirements, which could potentially – against the backdrop of CET1 capitalisation – undermine competitiveness without any objective justification. In extreme cases, there would even be an incentive for Institutions to replace high-quality CET1 with bonds that are MREL-eligible. This would not only increase the likelihood of a crisis but would also complicate resolution action and potentially make it less effective.

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In order to avoid these types of misaligned incentives, this MREL Policy sets out specific calibration approaches that, where the requirements or expectations indicated are met, enable MREL ratios to be set that are moderate compared to elsewhere in Europe. In order to ensure at the same time that the requirements for the Policy – in particular the high level of CET1 (or the presence of other subordinated capital instruments) – continue to be met in future, the MREL calibration takes a generally conservative approach to the subordination requirement, i.e. the subordination requirement is relatively strict according to an international comparison.

The approach taken in this Policy to setting the MREL results not only in benefits for the financial system as a whole in the event of a crisis due to the availability of high-quality own funds, but also results in direct benefits for systemically important Institutions, which profit from a comparatively low MREL ratio.

5. MREL: requirement and calibration

According to Article 58(1) RRA, each entity falling under Article 2(1)(a) to (d) (Institutions and other affected entities) shall comply at all times with requirements for own funds and eligible liabilities ("MREL"), where prescribed under Article 58 to Article 61 RRA (i.e. TELOF >= MREL).

Resolution Entities shall comply with MREL at the level of the Resolution Group ("external MREL"), irrespective of whether under this scenario the setting of resolution instruments or their liquidation (according to insolvency law) is anticipated for (other) group entities. Institutions that are subsidiaries of a Resolution Entity or a third-party entity, but not a Resolution Entity themselves, shall comply with the MREL on an individual basis ("internal MREL" [3]).

According to Article 58(3) RRA, MREL is expressed as the amount of own funds and eligible liabilities that is both

- risk-based, i.e. according to the total risk exposure of the entity concerned calculated in Article 92(3) CRR ("risk-based dimension"), and also
- non-risk-based, i.e. according to the size of the total exposure measure calculated in Article 429(f) CRR ("leverage-based dimension")

as a percentage, in each instance to one decimal place ($MREL_{TREA}$ und $MREL_{LRE}$). Both MREL requirements apply in parallel with each other.

5.1 MREL calculation

The level of MREL is obtained from the sum total of the loss absorption amount ("LAA") and the recapitalisation amount (RCA) both for the risk-based dimension ($MREL_{TREA}$) and for the leverage-based dimension ($MREL_{LRE}$).[4]

If the resolution plan for the entity foresees liquidation, the resolution authority will generally limit the level of MREL to the loss absorption amount, and make provisions for it accordingly in the resolution plan (cf. Article 58b(3) RRA).

Any legally binding supervisory measures increasing the minimum requirements for own funds for the Resolution Entity (so-called "P2R") are taken into account when calculating the LAA as well as the RCA. Accordingly, the total SREP capital requirement ratio (TSCR) is a decisive element of the calculation of LAA and RCA.

[3] The "internal MREL" applies for subsidiaries of a Resolution Entity that have not been designated themselves as Resolution Entities (e.g. subsidiary bank based in another EEA Member State). Where specified in the resolution plan, such entities shall issue eligible (debt) instruments within the group, which are purchased and held by the respective Resolution Entity. If the subsidiary reaches a point that it is no longer "viable", these instruments will be written down or converted into own funds, and the entity's losses passed on to the Resolution Entity.

[4] Amounts are always indicated with no decimal places for the purposes of calculations under this Policy.

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If a decision concerning P2R (as part of the TSCR) is not available for the respective Resolution Group (e.g. on the grounds that there is self-consolidation requirement under Article 22 CRR), the resolution authority assesses P2R in accordance with the requirements set forth in Delegated Regulation (EU) 2021/1118.[5]

The subordination requirement "$TSLOF_{min}$" (see section 6) constitutes a mandatory lower bound for the MREL (floor). In such an eventuality, the MREL shall be ensured in full through own funds and subordinated eligible liabilities (TSLOF).

5.1.1 Loss absorption amount ("LAA")

For the purposes of calculating risk-based MREL ($MREL_{TREA}$), the LAA corresponds to the sum total of the requirements under Article 92(1)(c) CRR ("P1R") and Article 35c[bis] BA ("P2R"):

$$LAA_{TREA} = (TREA \times TSCR)$$

For the purposes of calculating non-risk-based MREL ($MREL_{LRE}$), the LAA complies with the requirements of Article 92(1)(d) CRR ("leverage ratio"):

$$LAA_{LRE} = (LRE \times LRR)$$

As a result, the LAA is not adjusted individually by resolution authorities.

5.1.2 Recapitalisation amount ("RCA")

For the purposes of calculating risk-based MREL ($MREL_{TREA}$), the RCA corresponds to the sum total of the requirements under Article 92(1)(c) CRR ("P1R") and Article 35c[bis] BA ("P2R"), adjusted in line with specific MREL variables (see section 5.2):

$$RCA_{TREA} = (TREA - BSD_{TREA}) \times \left(1 - Strat_{Transfer}\right) \times (TSCR + MCC)$$

For the purposes of calculating non-risk-based MREL ($MREL_{LRE}$), the RCA complies with the requirements of Article 92(1)(d) CRR ("leverage ratio"), adjusted in line with specific MREL variables (see section 5.2):

$$RCA_{LRE} = (LRE - BSD_{LRE}) \times \left(1 - Strat_{Transfer}\right) \times LRR$$

The RCA is adjusted, i.e. reduced or increased, by the resolution authority according to the criteria set out in section 5.2.

5.2 MREL variables

As a result, the LAA is not adjusted individually by resolution authorities. The RCA is adjusted by the resolution authority in line with the criteria and variables described in this section.

[5] Commission Delegated Regulation (EU) 2021/1118 of 26 March 2021 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the methodology to be used by resolution authorities to estimate the requirement referred to in Article 104a of Directive 2013/36/EU of the European Parliament and of the Council and the combined buffer requirement for Resolution Entities at the Resolution Group consolidated level where the Resolution Group is not subject to those requirements under that Directive, C/2021/1794.

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Adaptive variables that reduce the RCA (BSD and $Strat_{Transfer}$) are only recognised by the resolution authority if the Resolution Entity complies with the following requirements:

1. The full write-down and conversion of capital instruments and eligible liabilities according to Article 78(3) in conjunction with Article 49(2) RRA (“WDC”) is possible at all times;
2. Strategies are effectively incorporated into (intergroup) internal procedures and control mechanisms, can be implemented without undue delay, ensure the continuation of critical functions as well as access to important financial market infrastructures, and are regularly reviewed;
3. The effects of individual parameters and strategies are quantified in a granular and sufficiently separable manner
4. The feasibility of the strategies at all times is not impacted in a significantly negative manner by any contractual and/or statutory requirements (e.g. provisions to the contrary in third countries, restrictions on the transferability of shares or economically equivalent impediments such as “change-of-control” clauses) and/or third party dependencies or decisions (all legal entities that are not part of the Resolution Group, e.g. outsourcing providers) and/or conditions of specific financial market infrastructures (stock exchanges, CSDs, CCPs)
5. The additional special requirements (5.2.1 and/or 5.2.2) are met; and
6. The fulfilment of requirements 1 to 5 is documented in detail in writing each year to the resolution authority as at 31 December until the expiry of the relevant time limit specified in Article 4(f) of the Liechtenstein Recovery and Resolution Ordinance (*Sanierungs- und Abwicklungsverordnung*; *SAV*, hereinafter referred to as the “RRO”) (“Updating of the restructuring plan”)

The resolution authority takes due account of the statements made in resolution planning and in the identification of MREL. When doing so, the resolution authority focuses in all instances on the Institution’s profile on the respective reference date without projecting any potentially feasible recovery options (e.g. sale of assets or participations according to the requirements of the recovery plan). Any reductions in MREL owing to projected recovery options are thus not applied by the resolution authority.

5.2.1 Balance sheet depletion (“BSD”)

The resolution authority assumes that the total assets of a bank recapitalised by the implementation of resolution instruments (post-resolution) are lower than the total assets of the entity at the time of resolution planning (pre-resolution). This is based amongst other things on the assumption that credit risks, which account for the vast majority of TREA, will crystallise during the course of resolution and that TREA is reduced accordingly. The greater the proportion of the total weighted credit risk positions (T_CREA) of the TREA for the entity under consideration, as a general rule the higher the variable BSD will be set by the resolution authority. The upper limit (cap) for BSD is the sum total of LAA and CBR or, if lower, 10% of TLOF:

$$BSD_{LRE} = min(LAA_{LRE} + CBR; 0.1 \times TLOF)$$

If the BSD is expressed as a proportion of TREA, risk weighting is taken into account accordingly:

$$BSD_{TREA} = min(LAA_{TREA} + CBR; 0.1 \times TLOF) \times \frac{TREA}{LRE}$$

If the proportion of the total weighted credit risk positions (T_CREA) of the TREA at the level of the SPE reaches 80% on annual average, as a principle the resolution authority applies the cap mentioned above.

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5.2.2 Transfer strategies and transfer capacity (“$\text{Strat}_{\text{Transfer}}$”)

Where the implementation of a transfer strategy (e.g. the transfer of shares [share deal] and/or balance sheet items [asset deal] to third parties [private sector, asset management vehicle, bridge bank[6]]) is the preferred resolution action set out in the resolution plan, the resolution authority thereby (potentially) acknowledges limited recapitalisation requirements. The authority sets the variable $\text{Strat}_{\text{Transfer}}$ with the aim of adjusting external MREL in line with the respective prospects of success and credible preparatory work carried out within the entity on the implementation of the strategy.

When taking account of the $\text{Strat}_{\text{Transfer}}$, the Resolution Entity shall establish that the requirements indicated have been met, in addition to that referred to in section 5.2, with reference at least to the following criteria:

1. Adequate data infrastructure to ensure that relevant data are available at all times (e.g. granular credit, shareholding and investor data) for the (provisional) valuation and the transfer (“Management Information System”)
2. Availability at all times of a secure virtual data room for due diligence purposes
3. Availability of an appropriate internal procedure for launching a sales process (roadshow) that does not significantly reduce market confidence in the Institution
4. The conduct of market analyses concerning potential buyers of shares and/or assets at least once per year, including corresponding appraisals of sale value and an effective process for preventing conflict of interest in relation to the sales process
5. The conduct of appraisals concerning the effects of the implementation of the strategy on the Institution’s rating, credit default insurance prices (CDS spreads) and the funding situation (in particular in terms of the reduced scope for unsecured funding) at least once per year
6. The capacity to draw up a detailed report without undue delay on the separability of assets and liabilities (“SAR” inventory)
7. The capacity to carry out a liquidity analysis without undue delay in accordance with section 4.2 of the EBA guidelines (EBA/GL/2022/01)
8. The drawing up each year of a detailed SAR, starting from 31 December 2023 at the latest; and
9. The establishment and regular evaluation of an internal process for the operational implementation of the transfer strategy (“transfer playbook”), based *inter alia* on targeted internal test processes, starting from 31 December 2023 at the latest

When assessing the information presented, the resolution authority refers to European practices and recognised standards, including in particular the EBA Guidelines on transferability to complement the resolvability assessment for transfer strategies (EBA/CP/2022/01), the EBA Guidelines on improving resolvability for institutions and resolution authorities (EBA/GL/2022/01), the SRB Operational guidance for banks on separability for transfer tools (2021) and the SRB Operational guidance on the identification and mobilisation of collateral in resolution (2022).

When fulfilling the above-mentioned requirements, the resolution authority sets $\text{Strat}_{\text{Transfer}}$ at a level between 0.15 and 0.25 (15% to 25%). When specifically implementing the variable, the resolution authority takes account of the quality of the assets at the time of resolution planning. As part of this process it focuses in principle on four figures and the respective threshold values, each expressed in terms of the Resolution Group (with the exception of the LCD ratio, which is calculated at the level of the SPE):

Figure (in %)	Definition	Threshold value (annual average)
NPE ratio	NPE/LRE	<3% on annual average
LCD ratio (SPE)	HQLA level 1/covered deposits	>125% on annual average
Credit risk density	$T_C REA/T_C OE$	<33% on annual average
NSFR	ASF/RSF	>125% on annual average

[6] These reflect the resolution instruments under Article 49(3)(a) to (c) RRA (sale of the entity, hiving down of assets, bridge bank).

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As a general rule, the resolution authority proceeds as follows: if the Resolution Group achieves at least two of the four threshold values, $Strat_{Transfer}$ is set from 0 to 0.15. If it achieves three threshold values, $Strat_{Transfer}$ is set at 0.20. If the group achieves all threshold values, $Strat_{Transfer}$ is set at 0.25. If a threshold value is overshot or undershot, this will not result in an immediate change in the MREL requirement, but will rather be taken into account within the ordinary (annual) process for setting MREL.
If a threshold value is only marginally undershot, in exceptional cases the resolution authority may nonetheless assign a higher $Strat_{Transfer}$, provided that qualitative expectations (see above) are fulfilled by the respective Resolution Entity to a particularly high level, considered in terms of the above-mentioned European practices.

5.2.3 Market confidence charge ("MCC")

The resolution authority is entitled to raise RCA_{TREA} for the purpose of increasing market confidence in the entity after the projected implementation of the Resolution Strategies mentioned in the resolution plan (Article 58b(8) RRA). The respective increase in the RCA by the MCC is intended in particular to stabilise capacity for complying with regulatory conditions for authorisation (incl. in particular compliance with the minimum capital requirement after the resolution instrument has been implemented) thanks to increased post-resolution capitalisation (for instance for covering higher costs and disclosing a sufficient risk-absorption buffer after resolution). When calibrating the MCC the projected stabilisation requirement may not extend beyond the one-year horizon (Article 58b(8) RRA).

Article 58b(9) RRA requires as follows:

$$MCC = CBR_{\%TREA} - CCyB_{\%TREA}$$

The MCC is not generally adjusted any further by the resolution authority (cf. Article 58b(1)0 RRA).

6. NCWO risk and subordination requirement

The NCWO ("no creditor worse off") risk refers to the risk that, as a result of the planned usage of write-down and conversion powers for non-subordinated liabilities that are not excluded from the application of these powers pursuant to Article 56 or 57 RRA, creditors owed claims pertaining to these liabilities may have to bear greater losses than they would in the event of liquidation (according to ordinary insolvency procedures).

The requirement to ensure that no creditors are worse off is one of the "General Principles on Resolution" (cf. Article 42(1)(g) RRA). The assessment of the NCWO risk and the setting of a subordination requirement ("$TSLOF_{min}$") is thus of central importance for the resolvability of an entity.

The purpose of $TSLOF_{min}$ is to reduce the NCWO risk. However, if the entity's resolution plan envisages liquidation as the preferred strategy, this institution (or undertaking) is not subject to a subordination requirement (TSLOFmin).

6.1 Assessment of the NCWO risk

In order to assess the NCWO risk, the Resolution Authority calculates the effects of a default from the perspective of implementing resolution instruments (write-down and conversion of eligible liabilities) on the one hand and the liquidation of the entity on the other. The assessment of the NCWO risk and the minimum value of $TSLOF_{min}$ is obtained from a comparison of the effects on the creditor (claims) affected by the resolution/liquidation.

The resolution authority assumes the following two default scenarios along with the respective assumptions and parameters:

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Resolution	Liquidation
The loss for creditors is calculated with reference to the "resolution haircuts": The value of creditor claims is reduced by the official write-down or conversion of bail-in-able liabilities. • In the event of a write-down, the value of the claim is reduced to 0. • In the event of a conversion, the creditor receives new equity instruments (shares) as partial compensation. For calculation purposes, the market value of these new shares is set at 25% of the original value of the claim (the write-down in the event of the conversion of borrowed capital into own funds is thus 75%).	The loss for creditors is calculated with reference to the haircuts under projected liquidation within the context of insolvency ("insolvency haircuts"): The value of creditors' claims is reduced by the losses (liquidation of assets at book value) and costs during the course of liquidation (base loss plus supplementary loss). The losses used for the calculation methodically include also those losses that led to the launch of liquidation procedures.
The sum of LAA_{TREA} and CBR is taken as the initial loss. $$initial\ loss = LAA_{TREA} + CBR$$ If the initial loss exceeds the amount of own funds as well as the amount of instruments in classes 5 and 6, the remaining uncovered loss is covered by the convertible portion from class 4. For calculation purposes, the market value of these new shares is set at 25% of the original value of the claim (the write-down in the event of the conversion of borrowed capital into own funds is thus 75%).	The sum of LAA_{TREA} and CBR is taken as the initial loss. $$initial\ loss = LAA_{TREA} + CBR$$ If the initial loss exceeds the amount of own funds as well as the amount of instruments in classes 5 and 6, the remaining uncovered loss is covered by class 4.
For the purpose of covering the loss, it is assumed that the entity will be recapitalised to the level of RCA_{TREA} through the conversion of bail-in-able liabilities (book value). • Conversion occurs according to the order of priority indicated in **Annex I** (*only German Version*), starting with the lowest class after eligible own funds, i.e. "*KO Class 6: Subordinated liabilities: Senior non-preferred*". Conversion occurs until the RCA is reached. • After conversion, senior creditors hold the residual amount of their original claims (borrowed capital) plus the new shares in the entity (own funds) with a reduced market value ($MV_{post\text{-}resolution}$ = 25%, cf. EBA/GL/2017/03).	A figure equivalent to 10% of TLOF less the base loss (LAA_{TREA} plus CBR) is taken as the supplementary loss, which takes account of asset disposal costs: $$additional\ loss = (TLOF - LAA_{TREA} - CBR) * 0.1$$

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The resolution authority applies the following parameters when carrying out the valuation:

- The ("[sub]consolidated") own funds positions at the level of the Resolution Group are used to compute own funds;
- Amounts at the level of the Resolution Entity (SPE; e.g. the group's parent company) are used to compute all liabilities (i.e. also for elements of TLOF, TELOF and TSLOF other than own funds);

- The ("[sub]consolidated") requirements at the level of the Resolution Group (for calculating LAA_{TREA}, RCA_{TREA} and CBR) are used to compute own funds and capital buffer requirements;
- In order to ensure a conservative computation of available bail-in-able liabilities, both scenarios assume the flight up to 10% of the creditors from the insolvency class concerned (insolvency class 4), whose bail-in-able claims have a residual term shorter than one year. These liabilities are assumed to be unavailable for the purposes of the calculation, in the same manner as non-bail-in-able claims in class 4 (e.g. interbank deposits with a residual term shorter than seven days). As such, at minimum 90% of the total amount of these liabilities are eligible for write-down and/or conversion.
- The market value of the newly issued shares (converted liabilities) is set at 25% of the original market value of the written down shares ($MV_{post\text{-}resolution} = 25\%$).[7]

If the value of the creditor claims under the resolution scenario is lower than it is under the liquidation scenario ("residual values"), the approach also provides the amount of bail-in-able liabilities that shall be replaced by subordinated eligible liabilities ("deficit") in order to set-off the hypothetical loss calculated ("equilibrium"), thereby neutralising the NCWO risk in arithmetical terms. Under the opposite scenario, i.e. where the value of creditor claims under the liquidation scenario is lower than it is under the resolution scenario, this results in the surplus of subordinated instruments. In this eventuality, creditors owed unsecured subordinated liabilities are in a better position under the resolution scenario than under the liquidation scenario. The difference between the value of creditor claims under a resolution scenario and the value of creditor claims under a liquidation scenario ("surplus" or "deficit") is referred to as "$Equi_{\Delta}$"; this is the amount by which TSLOF would have to be increased (or reduced) in order to ensure that "deficit"/"surplus" = 0.

A sample calculation is contained in **Annex II** (*only German Version*).

6.2 Determination of the subordination requirement

Pursuant to Article 58a(9) RRA, the resolution authority is allowed to require the entity to ensure that a particular portion of MREL is made up of own funds and Subordinated Eligible Instruments" (TSLOF), where necessary in order to reduce the NCWO risk ("subordination requirement"). The subordination requirement is part of the general MREL requirement ("of which" position) and shall therefore be taken into account when computing the maximum distributable amount ("M-MDA", see section 8). The common equity tier 1 (CET1) that is used to fulfil the CBR may not be used to fulfil the subordination requirement.

Starting from the equilibrium described in section 6.1, after a comparison between a resolution and a liquidation scenario, the minimum amount of the subordination requirement ("$TSLOF_{TREAmin}$") may be presented as an amount ("$TSLOF_{min}$") and as a percentage of TREA (to one decimal place).

In order to calculate $TSLOF_{min}$, TSLOF is thus arithmetically reduced ("minimised") until the equilibrium is reached (i.e. difference between the outcomes under the two scenarios [resolution vs. insolvency] = 0; there is neither a surplus nor a deficit). The amount of subordinated liabilities and own funds (TSLOF) is thus reduced (in the event of a surplus) or increased (in the event of a deficit) by $Equi_{\Delta}$:

$$TSLOF_{min} = TSLOF \pm Equi_{\Delta}$$

$TSLOF_{min}$ is defined as a percentage of the TREA for the Resolution Group (or, if no Resolution Group has been defined, at the level of the Resolution Entity) ("$TSLOF_{TREAmin}$").

A sample calculation is contained in Annex II (*only German Version*).

If it is sufficiently likely that the failure of the entity would give rise to a systemic risk, the resolution authority shall in any case ensure that the MREL is set in general terms at least at 8% of TLOF with own funds and

[7] Concerning the reasons, see SRB MREL Policy (2021), Box 1.

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Subordinated Eligible Instruments (Article 58a Abs. 6 RRA; so-called “fished bank”). There is no $TSLOF_{min}$ cap for a “fished bank”.

In order to achieve a very high level of resolvability and $TSLOF_{min}$, the resolution authority takes account of the target definition measured in TLOF for systemically important Institutions (Article 3a(1)(15) BA), irrespective of whether or not the entity concerned is a “fished bank”. As regards systemically important Institutions in Liechtenstein that are not “fished”, the Resolution Authority sets a lower limit for $TSLOF_{min}$ (floor) in order to ensure that the NCWO risk is properly addressed at all times, applying the formula[8] provided for in Article 58a(6) RRA, although less CBR. The $TSLOF_{min}$ floor for systemically important Institutions in Liechtenstein is thus obtained as follows:

$$TSLOFmin\ (Floor) = 8\%\ TLOF\ x\ \left(1 - \left(\frac{3.5\%\ TREA}{18\%\ TREA + CBR}\right)\right) - CBR^{9}$$

If an entity is not “fished”, $TSLOF_{min}$ is subject to a cap at the level of the higher of

- 8% of TLOF
  or
- (TREA x TSCR x 2) + CBR

(Article 58a(9) and (12) RRA). As an “of which” position, $TSLOF_{min}$ is by definition not higher than MREL. The authorities are not permitted by law to set a lower cap.

When divided by TREA as the denominator, this accordingly results in the minimum amount of the subordination requirement measured in terms of TREA (“$TSLOF_{TREAmin}$”) as follows:

$$TSLOF_{TREAmin} = \frac{TSLOFmin}{TREA}$$

$TSLOF_{TREAmin}$ is set during the course of resolution planning and the determination of MREL, where applicable by a joint decision by the resolution college, and is announced to the entities affected.

6.3 Exclusion of particular liabilities from write-down and conversion

When applying the bail-in-instrument, the resolution authority is entitled to exclude particular eligible liabilities either entirely or partially from the scope of write-down or conversion powers (Article 57(1) RRA). This occurs in particular where a bail-in would not be possible within a reasonable time frame or where exclusion is absolutely necessary and reasonable to avoid a risk of extensive contagion – above all as regards the recoverable deposits of natural persons and SMEs – that would disrupt the operation of financial markets to such an extent that it could have a significant impact on the economy (cf. Article 57(1)(a) to (d) RRA).

Overall, liabilities shall be excluded where the resolvability would otherwise be negatively impacted. Thus, an instance of this potentially arises where eligible instruments have been largely distributed to retail depositors (cf. the requirements laid down in Article 57a RRA *mutatis mutandis*).

If it is sufficiently likely that liabilities will be excluded from the scope of the bail-in pursuant to Article 57 RRA, the entity concerned shall fulfil the MREL with own funds or other eligible liabilities in order to cover excluded liabilities pursuant to Article 57 RRA (Article 58b(22) RRA).

[8] It should be taken into account that the subordination requirement also has an impact, where applicable, on the level of MREL as a floor.

[9] NB: the respective holdings on each application level (resolution group or resolution entity) corresponding to the application level for the MREL set shall be used when calculating the floor and cap. Holdings at the level of the resolution entity are not mixed with holdings of the resolution group.

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The issue as to whether particular liabilities should in principle be excluded is determined with reference to the following threshold values:

1. These liabilities account for more than 10% of all liabilities with the same insolvency ranking (Art 58a(10) RRA); or
2. These liabilities account for more than 5% of TLOF (Art 58a(15) RRA).

The resolution authority monitors according to a standardised reporting process whether particular categories of eligible liabilities (e.g. medium-term notes) exceed these threshold values.

The resolution authority expects Institutions to take account of these requirements concerning the exclusion of liabilities within their internal processes and also to be able to identify any such impediments to resolvability and the implementation of the resolution plan at any time.

7. Transitional provisions

The MREL (including the subordination requirement) shall be complied with by the entity in full by 1 January 2026 at the latest. Owing to the delay in the entry into force of the BRRD II in Liechtenstein compared to the EU Member States and the short transition period under the BRRD II (1 year), when implementing it at national level a decision was made not to specify in the legislation any specific dates for "interim targets" for achieving the MREL. However, the resolution authority shall set interim targets for entities each year during the transition period (para. 6 taking account of the requirements laid down in para. 7 of the above-mentioned Article).

An MREL requirement of 90% generally applies during the transition period. The transition period will start when the MREL decision takes effect in 2023 and will end on 1 January 2026.

The resolution authority is empowered to adjust time frames individually at any time.

8. Maximum distributable amount ("M-MDA")

Entities that do not fully comply with the requirements for $MREL_{TREA}$ and/or $TSLOF_{TREAmin}$ in addition to the CBR shall report this to the resolution authority without undue delay, i.e. no later than five days after the shortfall became apparent, via the e-service console (ad-hoc report "Report pursuant to Article 20a RRA [M-MDA]") (Article 20a(1) RRA). However, the resolution authority generally expects such an ad hoc report to be made already in the event that a shortfall in the new future is highly likely.

In its report the entity shall address the criteria referred to in Article 20a(2) RRA (including in particular the reason, duration and magnitude of the failure and its impact on resolvability, as well as the implementation of the resolution plan). Detailed additional submissions in order to complete and/or update the factual position (e.g. updating of estimates for a return to compliance) are permitted and welcome at any time. The entity should also be ready to submit reports at a higher frequency.

After consulting with the FMA (as the competent supervisory authority), the resolution authority assesses on the basis of submissions and any other official findings whether it is necessary to impose restrictions on distribution with reference to Article 20 RRA, in particular in order to maintain resolvability. The resolution authority shall repeat the assessment at least once each month (Article 20(3) RRA).

After consulting with the FMA, the resolution authority shall once again impose restrictions on distribution in general terms on the entity and/or the Resolution Group at the latest after nine months of consecutive shortfall. The resolution authority is only allowed to refrain from doing so if any of the alternative scenarios referred to in Article 20a(4) RRA applies (in particular market-wide disruption of financial stability).

The method for calculating M-MDA is set out in Annex 4 RRA. This follows the approach to calculation under Article 4q BA (restriction according to the respective quartile).

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9. Submissions and data quality

Submissions and event-driven reports shall always be filed via the e-service console ("event-driven reports", unless indicated otherwise by the resolution authority, for instance by providing for standardised periodic reports). Documents shall be bundled together into a ZIP file prior to uploading. Please send documents in a format that can be processed by the resolution authority, i.e. no image files or blocked PDF files.

The entity subject to reporting requirements is responsible for ensuring that submissions are substantively and formally correct, and for the accuracy of the data submitted. It should put in place appropriate processes and checks in order to ensure data quality and incorporate these into its internal control system (ICS) and into risk management with reference to Article 7a(2)(d) BA. If any reports are returned for review or resubmission following data quality checks by the FMA or the European supervisory authorities, the entity subject to reporting requirements shall carry out a review of its existing systems and processes and make any necessary adjustments in order to avoid similar errors in future reports.

10. Final provisions

This Communication was issued by the Executive Board of the FMA on September 13th 2022 and will enter into force on May 1st 2023.

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