# MREL for Swedish Banks

*Societe Generale*

*Stockholm 29 August 2019*

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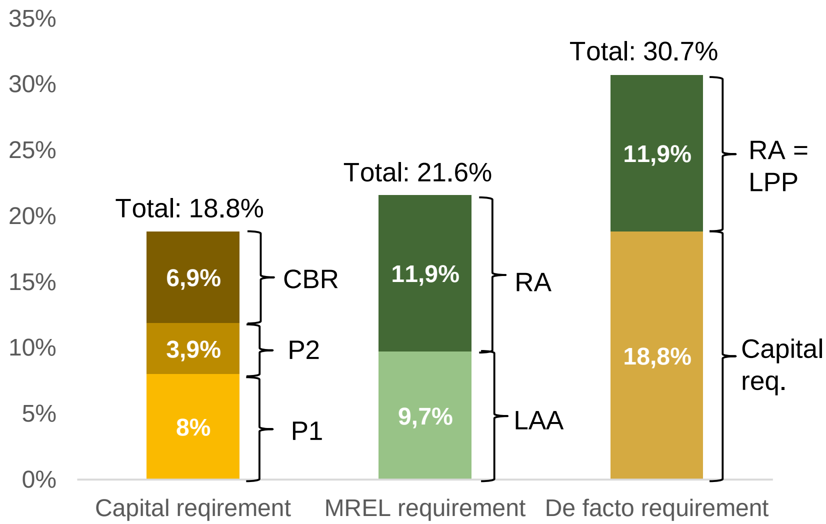
# Riksgälden’s current MREL policy

## Institutions are bound by the de facto requierment*




*Average requirements for the three largest Swedish banks. Data as of Q4 2018.

*Riksgälden’s current calibration formula:*

$$\mathbf{MREL} = \underbrace{P1 + P2R - P2macro}_{\text{Loss absorption amount}} + \underbrace{P1 + P2R}_{\text{Recapitalization amount}}$$

## Liabilities proportion principle*

| Institution | SEK billion |
|---|---|
| Handelsbanken | 86 |
| SEB | 87 |
| Swedbank | 73 |
| Other | 41 |
| **Total** | **287** |

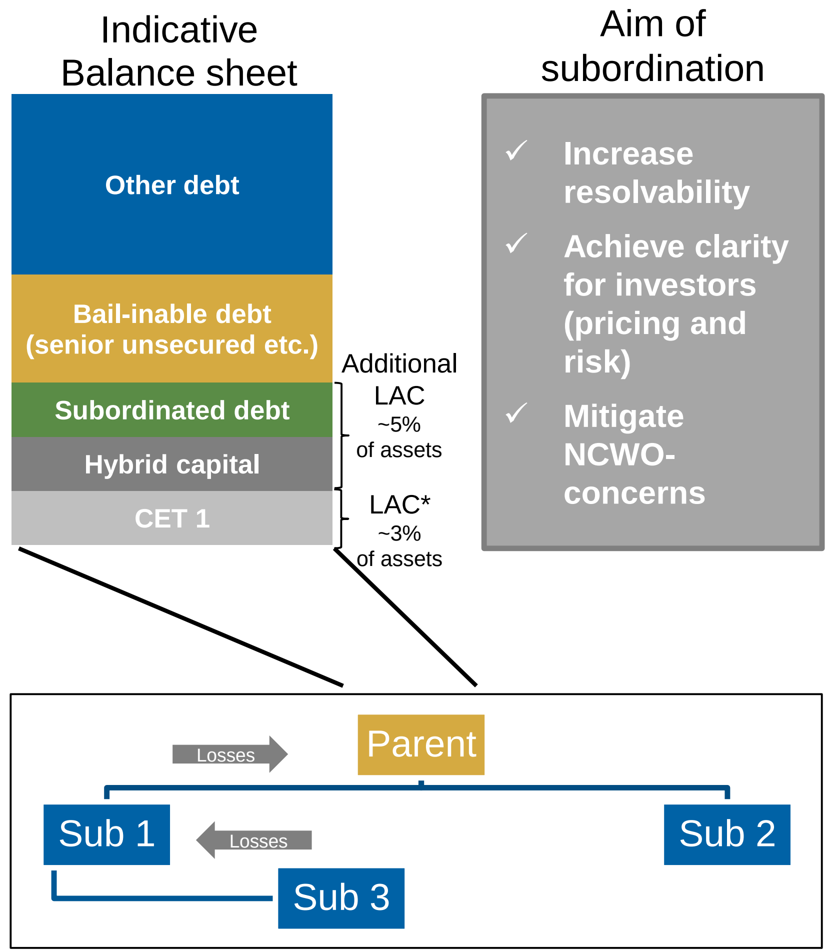
*Based on capital requirements as of Q4 2018. Possible maturity and management buffers not accounted for.

The Liabilities proportion principle (LPP) mandates that institutions hold an amount equal to the recapitalization amount in subordinated debt instruments.

This ensures a separation of going and gone concern resources, and that capital buffers may be used as intended

# Sweden’s framework allows for statutory subordination

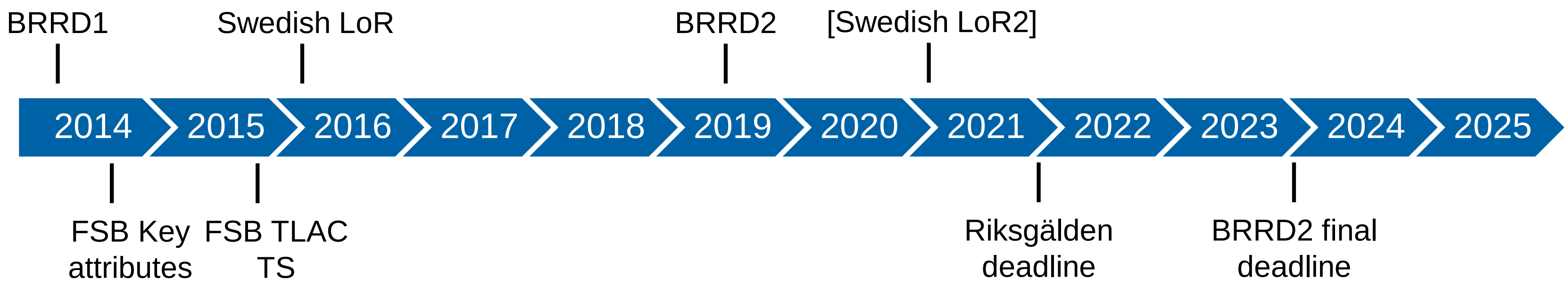
- Legislation specifying insolvency priority in place since 1st of January 2019
- This allows for issuance of senior non-preferred (SNP) instruments with statutory subordination
- Contractual and structural subordination (e.g. senior instruments issued from a HoldCo) allowed, but not foreseen in practice
- Swedbank and SEB received rating uplifts (Moody’s) for senior unsecured debt in April 2018 due to expectation of increased additional loss absorbing debt*
- Internal (subordinated) MREL-requirements allow for upstreaming of losses to the resolution (parent) entity




*Moody's takes rating actions on four large Swedish banks due to MREL requirements*, Moody’s Investors Service, 2018-04-20

*Loss absorbing capacity. Moody’s accounts for loss absorbing debt within its loss given failure framework while S&P uses the term ALAC.

# BRRD2 finalized on EU-level




- BRRD2 introduces additions and changes to the current directive, mainly regarding MREL
- The calibration (including internal MREL) will be set in law to a higher degree
- Mandatory subordination is introduced
- Possibility of M-MDA restrictions implies that capital buffer requirements are added on top of the MREL-requirement
- Additional measures to deal with breaches of the MREL-requirement are also introduced
- The transposition in Sweden is subject to a public inquiry. Specific changes to the current MREL-policy is not yet known. Riksgälden has however communicated the following:
  - The current MREL-policy is largely compatible with BRRD2
  - It is essential that banks begin their issuances of subordinated debt instruments. The banks shall achieve the target levels by 1st of January 2022.

# MREL instrument considerations

## Maturity

- Maturities of 5 years or longer are foreseen
- Refinancing risks are a function of funding mix, including maturity, as well as the level of the MREL-requirement
- M-MDA article in BRRD2 stipulates that current market environment shall be taken into account before deciding on any measures to limit dividend payments
- Refinancing risks are a matter for the SFSA under going concern

## Callability

- European banks have started to issue callable SNP-bonds although some legal uncertainty remain under current legal framework
- BNP Paribas was first (early 2019) to issue EUR-denominated callable SNP-bond
- Riksgälden has not communicated any position on callability
- Clarification is expected through BRRD2 and EBA RTS

## Subordination levels

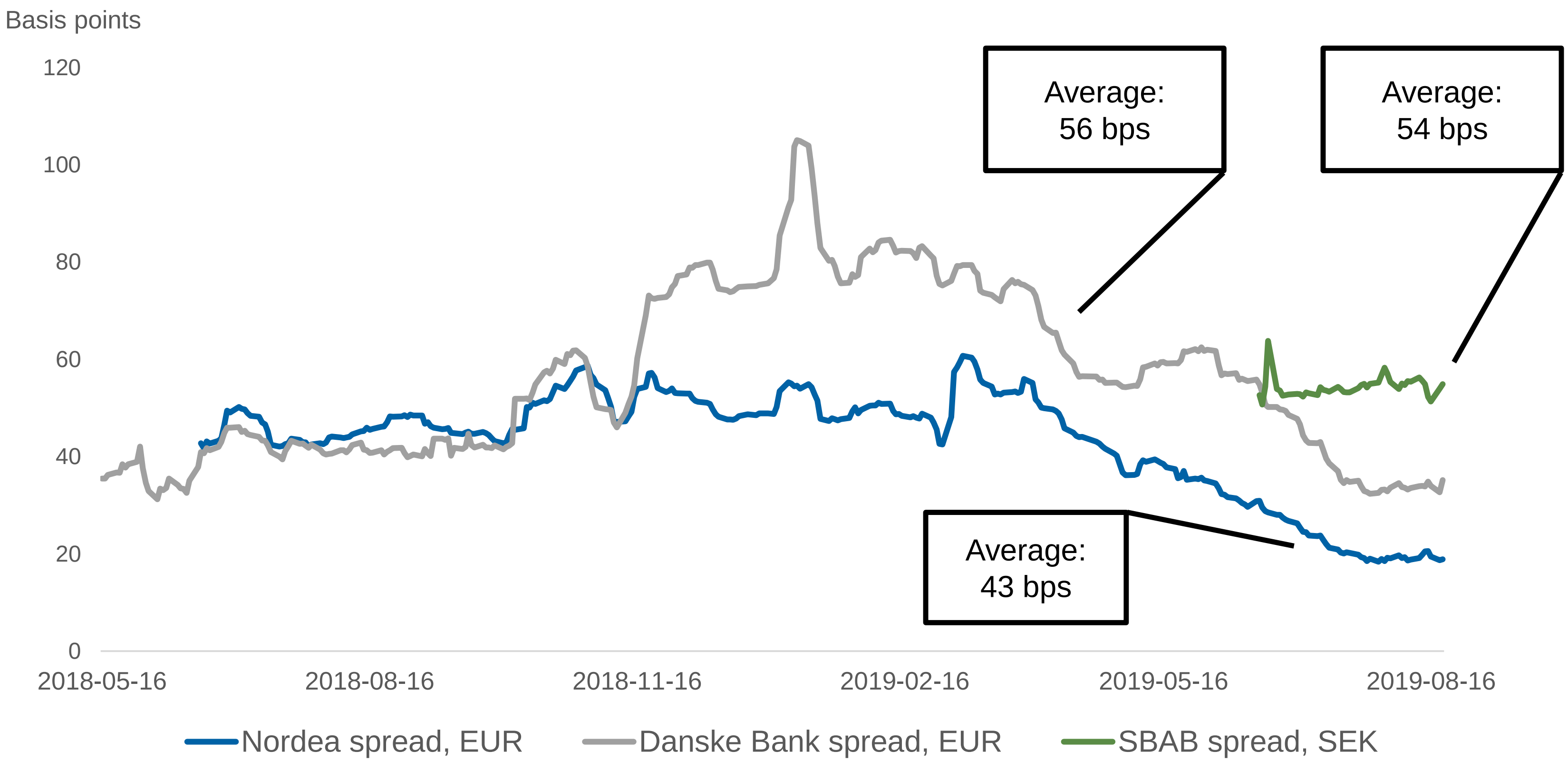
- Riksgälden's general conclusion is that the current MREL-policy is largely compatible with the new legislative framework
- The prudential formula for subordination, 2*(P1+P2)+CBR is equal to the current de facto requirements for Swedish banks
- BRRD2 introduces the possibility for senior allowance
- Riksgälden's view is that subordination is of high importance to ensure investors certainty, and to mitigate NCWO concerns. The subordination requirement was thus set at 100% for the current MREL-policy.

## FX-mix

- SEB, Swedbank and Handelsbanken are likely to issue large parts of their subordinated debt requirements in EUR and USD
- Other Swedish systemic banks are likely to issue larger parts in SEK
- The current senior unsecured SEK-denominated market is limited in size, but may increase in subordinated space due to higher yields?

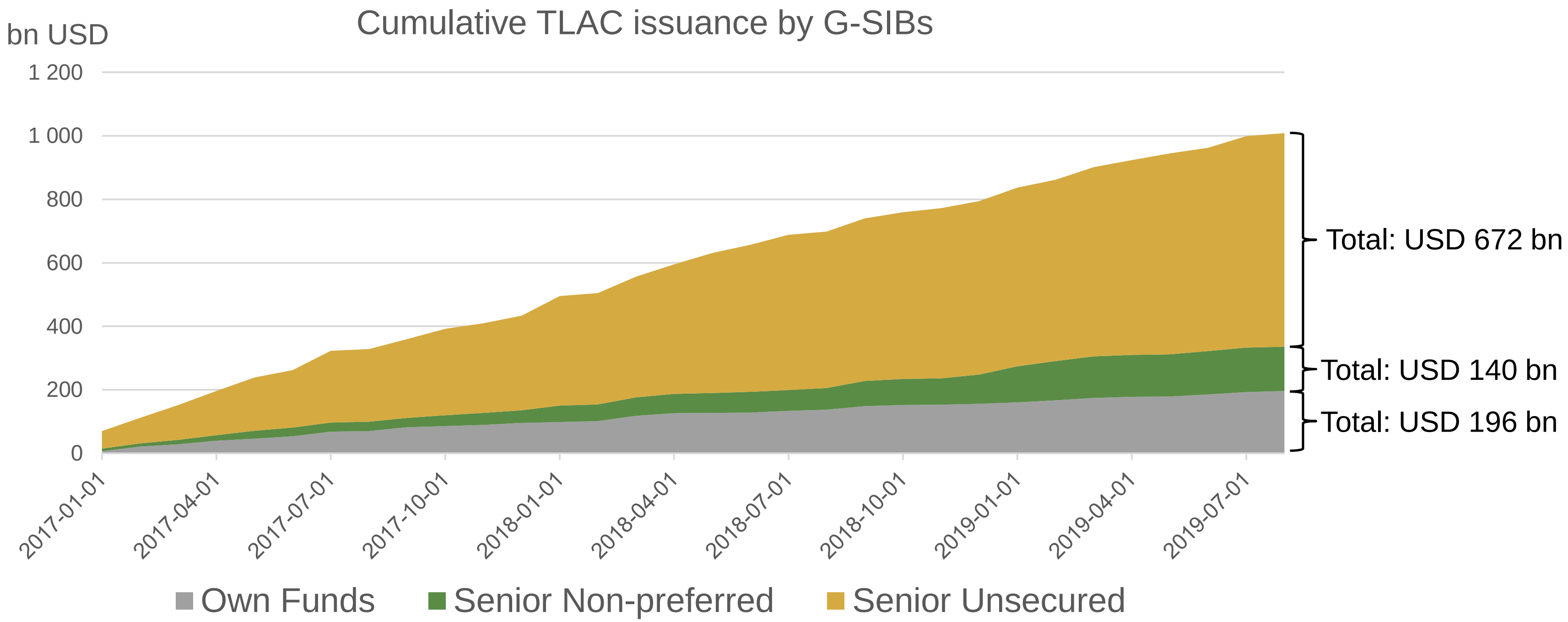
# Subordinated debt for Nordic banks

Difference in spreads between senior unsecured and senior non-preferred bonds for selected Nordic banks




Note: Mid Z-spread (bps)
Source: Riksgälden based on Bloomberg

# The global TLAC/MREL market has been established




Source: Riksgälden based on Bloomberg.

- The activity in 2019 has generally been good, and the supply is well absorbed by the market
- Riksgälden is monitoring developments and is in a continuous dialogue with the banks

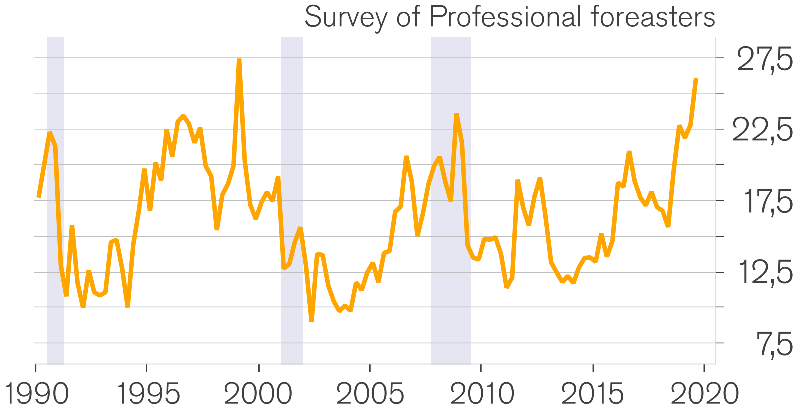
# The recent international development

- Highly dramatic financial markets, in particular the radical repricing in the bond market

- Driving forces:
  1. Growing global recession fears – inverted yield curves
  2. escalating US-Chinese trade conflict
  3. a traumatic (hard) Brexit more probable with new PM (?)
  4. geopolitical concerns (Iran, Hong Kong, Kashmir)
  5. Major central banks pawing the way for more stimulus

- Less dramatic developments in the real economy – but downside risks have increased
  1. Stagnating world trade – reflecting weakness in German/Chinese economies
  2. The ongoing slump in manufacturing – growth in Chinese industrial production at a 17-year low
  3. Economic indicators generally weaker (IFO, ISM)
  4. US economy still resilient on the surface -- the expansion is now the longest ever recorded

**US: Probability of decline in Real GDP in 4qtrs**




Source: SNDO

# The Swedish economy: Recent developments

- Q2 GDP on the weak side ("snabben"): -0.1% q/q, 1.4% y/y
    1. Household consumption grew but broad-based weakness elsewhere
    2. Global downturn in manufacturing less visible in Sweden
    3. Largely stable house/apartment prices
    4. Strong retail sales in July good news for Q3
    5. Note: General revisions (13:e Sept) may change the picture
    6. Latest SNDO q2 GDP forecast slightly higher: 0.1% q/q, 1.4% y/y
- The unemployment rate moved higher in July to 7.1% (volatile but noteworthy that employment is falling too)
- The reform space is estimated at SEK 25 billion in the state budget for 2020
    1. SNDO assuming SEK 15 billion in latest forecast