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## **DANMARKS NATIONALBANK'S RESPONSE TO THE DANISH FINANCIAL SUPERVISORY AUTHORITY'S DISCUSSION PAPER**

### **Main principles for resolution of small and medium-sized banks and determination of minimum requirements for own funds and eligible liabilities (MREL)**

The Danish Financial Supervisory Authority has presented its preliminary considerations on how to resolve small and medium-sized banks, how to determine minimum requirements for own funds and eligible liabilities (MREL) and when the Danish Financial Supervisory Authority should revoke the banking licence or decide that the bank is failing or likely to fail.

Danmarks Nationalbank generally supports transparency for creditors in terms of how the institutions in which they are creditors will be handled in a resolution. It is imperative that all financial undertakings, regardless of size and complexity, can be resolved without the use of government funds. For a designated systemically important financial institution, SIFI, the Bank Recovery and Resolution Directive, BRRD, ensures that the institution's critical functions can be restructured to viability in a resolution.

For small and medium-sized banks, simpler resolution principles can be applied. The critical factor is that depositors covered by the Guarantee Fund can access their funds immediately, also if their institution is failing or likely to fail. In Danmarks Nationalbank's assessment, no additional financial stability considerations should be taken into account in the resolution of small and medium-sized banks, including, in general, no creditor protection consideration for unsecured creditors. Against that background, Danmarks Nationalbank finds that

- The Danish Financial Supervisory Authority's proposed MREL for small and medium-sized banks seem unnecessarily burdensome, while still not guaranteeing that unsecured creditors do not suffer losses, and
- simple principles for resolution without recapitalisation seem to be better in accordance with restructuring and resolution legislation for small and medium-sized banks.

The conditions for applying the BRRD powers are that:

- an institution is failing or likely to fail,
- no private sector solutions can be found, and
- use of the powers is in the public interest.

The assessment of whether or not use of the powers is in the public interest is made by the resolution authorities, based, inter alia, on the nature of the institution's business, its shareholding structure, its legal form, its risk profile and its interconnectedness to other institutions or to the financial system in general, the scope and complexity of its activities etc. and whether its failure and subsequent cessation under the rules of Part 15 of the Danish Financial Business Act would be likely to have a significant negative effect on financial markets or the economy in general.

The principle that use of the powers must be in the public interest is a balanced principle, which provides the necessary protection to the creditors in view of the fact that use of the powers may be quite intrusive in relation to e.g. the creditors.

Danmarks Nationalbank finds that the failure of a SIFI could undoubtedly jeopardise financial stability and that use of the powers would be in the public interest. In Danmarks Nationalbank's assessment, this does not generally apply to small and medium-sized banks. Legislation assumes that the resolution rules are applied in an appropriate and proportionate way. In this context, it may seem unnecessary to impose additional requirements on small and medium-sized banks.

The MREL contributes to ensuring that the authorities are able to resolve and restructure SIFIs without the use of government funds. At the same time, the MREL and other requirements imposed on SIFIs reduce the risk that unsecured creditors suffer losses in a resolution. These requirements are necessary due to the systemic importance of the SIFIs.

There is no need for the authorities to impose the same requirements on small and medium-sized banks, given that the same considerations do

not apply as regards financial stability and the economy in general. Thus, individual small and medium-sized banks have more leeway in deciding how much capital and subordinated debt they want, and hence the level of protection they want to provide to their unsecured creditors.

Danmarks Nationalbank notes that several comparable countries seem to want to determine MREL equivalent to the institution's solvency need for small institutions. The reason is that these are handled through simplified resolution, which generally does not require recapitalisation.

Danmarks Nationalbank suggests that in the resolution of small and medium-sized banks only the immediate access of covered depositors to their funds should be considered. This entails simple principles for resolution without recapitalisation, which is within the remit of current legislation and better in accordance with the spirit of the BRRD. Covered depositors' immediate access to their funds is ensured by transferring the funds to a healthy bank, as assumed in the discussion paper. Non-viable and non-critical activities should be closed through bankruptcy, meaning that they will not have to be recapitalised. Thus, it will not be necessary for small and medium-sized banks to comply with the MREL.

If the Danish Financial Supervisory Authority assesses that it will be necessary to continue all or some of the small and medium-sized banks to avoid jeopardising financial stability, Danmarks Nationalbank finds that their MREL should be determined in the same manner as for SIFIs.

Yours sincerely

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