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Minting new coinage: TLAC & MREL in the Eurozone

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TLAC and MREL have been described as 'two sides of the same coin', both pursuing the same aim of ensuring that banks have sufficient appropriate liabilities to make resolution, through loss absorption and recapitalisation, ie 'bail-in', a viable proposition. This is a key element in completing the elimination of 'too big to fail' and its associated bail-outs, and if today the TLAC side of the coin is relatively well defined, the MREL side suffers from a lack of clarity stemming from three main sources.

What metals? As with many coins, TLAC/MREL are an alloy, of two different substances for two different purposes, capital for loss absorbency, debt for conversion to new capital. Debt and capital are different, appeal to different investors, and carry differing risk/reward equations. The differentiation of these two elements within MREL needs to be clearly affirmed, and any temptation to legislate for MREL through capital-related requirements may encourage confusion.

What face value? The same coin cannot have two values, and the value of TLAC has been calibrated in international discussion at FSB level. It should be made clear in all EU jurisdictions, and in particular in the Eurozone, that there is no mileage in reopening debates on calibration that have already taken place.

The sooner the specifications of MREL for the Eurozone have been clarified, the better.

A common currency? TLAC was designed for GSIB's, and it is clear that this needs to be the starting point for MREL implementation. But MREL was intended for all banks, and we may need a range of MREL coins of differing sizes for differing types of banks, GSIB's, DSIB's, smaller banks that will be resolved, and the smallest banks that will be liquidated. Yet each of these four categories must carry some MREL coins in its pocket, for resolution of smaller banks in the Eurozone in late 2015 and earlier have shown that GSIB's with the deepest pockets are not necessarily the biggest MREL spenders!

The sooner the specifications of MREL for the Eurozone have been clarified, the better. This absence of clarity has weighed heavily on the European bank debt markets in the first months of 2016, and will continue to do so until Eurozone banks and their investors alike understand how this new currency will work.