



BANK OF ENGLAND

June 2018

The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

Policy Statement

Responses to Consultation on 'Internal MREL — the Bank of England's approach to setting MREL within groups, and further issues' and Statement of Policy



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The appendix to this document contains the Bank of England's policy for exercising its power to direct relevant persons to maintain a minimum requirement for own funds and eligible liabilities (MREL) under section 3A(4) of the Banking Act 2009.

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1 Statement of Policy

1 Introduction

1.1 The Bank of England (the Bank) published a consultation paper (CP) in October 2017, explaining policy proposals in respect of internal MREL and setting out proposed additions and amendments to the MREL Statement of Policy (SoP) that would be needed to address them. It also proposed amendments to the SoP to address operational continuity requirements and the setting of external MREL for multiple point of entry (MPE) groups. In addition, it provided an update on how the Bank intends to develop its policy on requiring firms to disclose and report their MREL resources, and on restrictions on firms investing in each other's loss-absorbing resources.

1.2 This Policy Statement provides feedback on responses to the CP and contains the Bank's updated SoP (in the appendix). The SoP sets out the Bank's policy for exercising its power, under the EU Bank Recovery and Resolution Directive (2014/59/EU) (BRRD) and associated UK legislation, to direct firms to maintain a minimum requirement for own funds and eligible liabilities (MREL) and to take other steps for that purpose under section 3A of the Banking Act 2009 (Banking Act).

1.3 The Bank's power of direction to set MREL applies to: (i) banks, building societies and certain investment firms (firms) that are authorised by the Prudential Regulation Authority (PRA) or Financial Conduct Authority (FCA); (ii) parent companies of such institutions that are financial holding companies or mixed financial holding companies (holding companies); and (iii) PRA or FCA-authorised financial institutions that are subsidiaries of such institutions or such parent companies. For the purposes of this document, references to an 'institution' should, unless otherwise stated, be taken to also include the entities referred to in (ii) and (iii). The Bank is the United Kingdom's resolution authority, and the PRA or FCA is the competent authority.

The purpose of internal MREL

1.4 MREL is a requirement for institutions to maintain (on an individual and, where applicable, a consolidated or sub-consolidated basis) a minimum amount of loss-absorbing resources. There are two types of MREL: 'external MREL', issued by a resolution entity, and internal MREL, issued by legal entities in a group that are not themselves resolution entities. Should a firm fail, external MREL helps to ensure that the firm's own financial resources can be used to absorb losses and recapitalise the business, so that it can continue to provide critical functions without relying on public funds. Internal MREL provides for the recapitalisation of subsidiaries and has the effect of passing up losses within the group, so that they can be absorbed by the shareholders and creditors of the resolution entity through the use of resolution tools.

1.5 Both internal and external MREL resources can be either in the form of regulatory capital ('own funds') or else debt liabilities that meet certain eligibility criteria ('eligible liabilities'). Banking groups will be expected to have sufficient MREL resources to ensure that they have credible resolution plans.

Legislative context

1.6 The Bank must set internal MREL in line with relevant statutory requirements. The principal requirements arise from:

- **The Banking Act and associated legislation.** The Banking Act and associated secondary legislation, including the Bank Recovery and Resolution (No. 2 Order) 2014 ('No. 2 Order'), transpose the BRRD into UK law. The No. 2 Order requires the Bank to set MREL, specifies the criteria that the Bank must consider when setting MREL, sets out the scope of entities and groups for which MREL must or may be set, sets certain eligibility requirements for MREL resources and imposes procedural requirements.
- **Regulatory Technical Standards on MREL.** The European Banking Authority's (EBA) RTS on MREL (the 'MREL RTS')¹ further specify the criteria which the Bank must consider when setting MREL. The MREL RTS are binding on the Bank.

1.7 By setting internal MREL, the Bank will also implement the Financial Stability Board (FSB) Total Loss Absorbing Capacity (TLAC) standard and the FSB's Guiding Principles for internal TLAC ('the FSB Principles') for UK Globally-Systemically Important Banks (G-SIBs) and support cross-border co-operation on resolution issues.

1.8 As noted in the CP, the European Commission has proposed a package of amendments to legislation that is relevant to MREL, including amendments to BRRD and the EU Capital Requirements Regulation 575/2013 ('CRR'). At the time of publication, this package remains under negotiation. The final outcome of any amendments and the timing of their implementation is therefore uncertain. The Bank will assess as necessary whether to make any changes to its MREL framework as a result of such amendments. The Bank is also committed to, before the end of 2020, reviewing the calibration of MREL, and the final compliance date, prior to setting end-state MREs. In doing so, the Bank will have regard to any intervening changes in the UK regulatory framework, due to the revision of BRRD and CRR, as well as firms' experience in issuing liabilities to meet their interim MREs.

Outline of this document

1.9 The Bank received 12 responses to its consultation from a variety of banks and industry bodies. This document provides feedback on the main issues raised in consultation responses, sets out where the Bank has made changes to its policy, and clarifies the Bank's policy approach where relevant.

1.10 The rest of the document is structured as follows:

- (i) **Summary of policy and revisions** provides an overview of the Bank's policy on setting MREL within groups, and further issues;
- (ii) **Feedback on Consultation** discusses the main themes raised in consultation responses and provides additional information on the Bank's approach where relevant;

(1) Commission Delegated Regulation (EU) 2016/1450

- (iii) **Next Steps** describes the interaction firms should expect to have with the Bank regarding internal MREL following this publication; and
- (iv) **Appendix** sets out the Bank's final SoP on the Bank's approach to setting MREL.

2 Summary of policy and revisions

2.1 Following review of the consultation responses, the Bank will retain the general approach to internal MREL that was proposed in the CP. In a small number of areas, however, the Bank has decided to modify aspects of its approach, as set out in more detail below.

Scope of internal MREL

2.2 The Bank will retain the approach to the scope of internal MREL that was proposed in the CP.

Calibration of internal MREL

2.3 The Bank will retain the approach to the calibration of internal MREL that was proposed in the CP. This involves taking into account:

- The resolution strategy applicable to the group and the credibility of the resolution plan;
- The availability of other uncommitted resources within the group that could be readily deployed to support the subsidiary;
- The scaling of internal loss-absorbing resources applied by overseas authorities to subsidiaries located in their jurisdiction.

2.4 In considering the availability of resources, the CP proposed that surplus MREL – the difference in requirements between external MREL and the sum of what must be issued to the resolution entity as internal loss-absorbing resources – should be readily available to recapitalise any direct or indirect subsidiary, as necessary to support the execution of the resolution strategy, and there should be no legal or operational barriers to this.

2.5 While the availability of surplus MREL remains a relevant factor in facilitating scaling towards the bottom of the range – the Bank has decided not to set requirements around the location and the form of surplus MREL at this stage. The Bank thinks it is appropriate to consider in more detail the issues relating to surplus MREL, in consultation with other authorities in crisis management groups (CMGs). It will also expect to review the availability of readily deployable surplus within the framework that it is developing for assessing resolvability and which we expect to consult upon later in the year.⁽¹⁾ The Bank therefore expects to clarify its approach to surplus MREL at a later date.

2.6 The Bank will retain the proposed approach to avoid double counting of MREL resources in groups. This means that the Bank expects that internal MREL for an institution will be increased by the amount of any internal MREL or equivalent investments it has made in other entities in the same group. The Bank is clarifying that this applies where the investments are not covered by

(1) As noted in the Bank's response to the Independent Evaluation Office's evaluation of its resolution arrangements, the Bank has committed to publishing summaries of major UK firms' resolution plans and its assessment of their effectiveness. The Bank will consult by the end of 2018 on the approach to assuring that banks have implemented policies which have been set to remove barriers to their resolvability, which is central to the Bank's strategic goal of making the resolution framework operational. See <https://www.bankofengland.co.uk/report/2018/independent-evaluation-office-report-evaluation-of-the-boes-resolution-arrangements>.

arrangements that ensure this outcome (such as a capital deductions regime for investments in own funds instruments in subsidiaries).

Internal MREL instrument eligibility

2.7 The Bank will retain the general approach to internal MREL instrument eligibility that was proposed in the CP. The Bank will, however, clarify its approach to eligibility in a small number of areas. Those areas include the holder of the internal MREL instrument and the inclusion of contractual triggers.

Holder of the instrument

2.8 In the CP, the Bank noted its view that ‘external issuance of MREL from non-resolution entity subsidiaries in both own funds instruments and eligible liabilities is also likely to constitute an impediment to resolution. In line with this, externally issued regulatory capital in subsidiaries of a resolution entity may be used to meet internal MREL to the extent that such capital qualifies as regulatory capital until the current end-state MREL date of 1 January 2022. After that point, only externally issued CET1 issued by such subsidiaries should be used to meet a subsidiary’s internal MREL and only then if the externally issued CET1 is required by local regulations.’

2.9 The Bank intends to proceed with the requirement that eligible liabilities issued by non-resolution-entity subsidiaries will only count towards internal MREL if issued internally within the group that the subsidiaries belong to. Where own funds instruments issued externally by a non-resolution entity subsidiary count towards that subsidiary’s individual capital requirement, under BRRD such instruments can count towards that subsidiary’s individual internal MREL. The FSB’s TLAC standard provides that such externally issued non-CET1 own funds instruments should not count towards internal TLAC from 1 January 2022. The Bank is clarifying that, whether or not this restriction is adopted through the revision of CRR and BRRD, firms should consider whether the conversion to CET1 of externally issued non-CET1 own funds instruments counting towards MREL could lead to a change in control of a subsidiary. The Bank may consider any challenges to resolvability presented by such instruments as part of assessing firms’ resolvability. The existence from 1 January 2022 of outstanding non-CET1 own funds instruments issued from non-resolution entity subsidiaries to holders outside the group, that are counted as MREL, may lead the Bank to set higher end-state MREL to compensate for those issuances.⁽¹⁾

2.10 The Bank notes that it generally expects to accept issuance indirectly to the resolution entity along the chain of ownership, as long as there are no technical obstacles to the resolution entity becoming exposed to losses through this chain. Direct issuance, or indirect issuance to the resolution entity that is not along the chain of ownership, could also be acceptable unless this poses a technical obstacle to resolution; for example, there are circumstances in which converting internal MREL to equity could result in a change of control or if there were significant governance or tax issues as a result of conversion.

(1) Similarly, for external MREL, where own funds instruments issued externally by non-resolution entity subsidiaries count towards group consolidated capital, under BRRD such instruments can count towards group consolidated MREL. Firms should consider whether the location of external MREL outside the resolution entity could create difficulties for resolution. The Bank may consider any challenges to resolvability presented by such instruments as part of assessing firms’ resolvability. The existence from 1 January 2022 of outstanding non-CET1 own funds instruments issued from non-resolution entity subsidiaries to holders outside the group, that are counted as MREL, may lead the Bank to set higher end-state MREL to compensate for those issuances.

Contractual triggers

2.11 In the CP, the Bank noted its view that ‘the absence of contractual triggers in both non-CET1 own funds instruments and MREL eligible liabilities is likely to constitute an impediment to resolution on the grounds that: (1) the joint home-host trigger envisaged by the contractual trigger provides the mechanism for the home and host authorities to agree whether additional resources are required by the relevant subsidiary in addition to the capital provided by the conversion of the internal MREL and; (2) the ability to trigger all internal MREL simultaneously provides assurance that all relevant subsidiaries are well-capitalised and ensures that the surplus resources are available to the subsidiaries (if any) that require additional resources. The Bank therefore expects institutions to include those terms in any internal MREL resources (including non-CET1 own funds).’

2.12 The Bank intends to take forward for internal MREL eligible liabilities the requirement that they be issued with a contractual trigger that provides the resolution authority of the material subsidiary with the opportunity to direct a write-down and/or conversion in the circumstances specified in the SoP. This approach will be reviewed, if necessary, in light of any changes to the BRRD and CRR.

2.13 The Bank is making some amendments to the formulation of the contractual triggers in the SoP, to provide more clarity on how the trigger should operate. Whilst firms are not required to adopt the language of the triggers *verbatim* and may need to make drafting changes (for example, to conform to definitions used in the applicable instruments), the trigger will need to provide the Bank as resolution authority of the material subsidiary with the opportunity to direct an immediate write-down and/or conversion to CET1 of the instrument, to an extent (which could be in full) determined by the Bank at the time of the triggering, where:

- (1) any own funds instruments of the firm have been written down and/or converted into equity pursuant to any statutory or regulatory power linked to the financial condition or viability of the firm; provided that, in the case of eligible liability instruments issued by subsidiaries of non-UK groups, the Bank includes in its direction a statement that the home resolution authority has either consented or has not, within 24 hours of the Bank having given it notice, objected to the write-down or conversion; or
- (2) a resolution entity in the firm’s group, which is a direct or indirect parent of the institution, is subject to resolution proceedings in the United Kingdom or elsewhere.⁽¹⁾

2.14 The contractual trigger should provide the resolution authority of the material subsidiary with the opportunity to direct either a write-down and/or a conversion (as directed by the resolution authority) in the circumstances specified in paragraph 2.13 above. However, the contractual trigger may be limited to provide for only write-down or only conversion if firms can demonstrate to the Bank that this credibly supports the group resolution strategy and the passing of losses and recapitalisation needs to the resolution entity. Firms should consider whether the specification of only write down or only conversion in the contractual trigger could pose a technical obstacle to resolution; for example, if there are circumstances in which writing down or converting internal MREL instruments could result in a change of control or significant governance or tax issues as a

(1) ‘Resolution proceedings’ mean the exercise of a resolution tool by an EEA resolution authority (including the use by the Bank of a stabilisation power under the Banking Act) or a third country resolution action taken by a third-country resolution authority.

result. The Bank may consider any challenges to resolvability presented by the specification of contractual triggers as part of assessing firms' resolvability.

2.15 With respect to non-CET1 own funds instruments, firms should consider whether the absence of such contractual triggers, covering the circumstances described in (2) in paragraph 2.13 above could create difficulties for resolution. In particular, such contractual triggers support the ability to coordinate the write-down and/or conversion of internal MREL across other subsidiaries, where this is deemed helpful to supporting the group resolution, so that all relevant subsidiaries are well-capitalised. In cases (either outside or in the course of resolution proceedings) where it is not possible to write-down and/or convert the non-CET1 own funds instruments to CET1 using statutory powers ⁽¹⁾, for example instruments governed by non-EEA law where there is no statutory or contractual recognition of UK bail-in rules, the Bank could determine that it needs to use its powers under section 3A of the Banking Act to direct relevant persons to address impediments to resolution, in particular through a direction to endeavour to renegotiate instruments under section 3A(4-5). The Bank may consider any challenges to resolvability presented by such instruments as part of assessing firms' resolvability.

2.16 The Bank notes that there is likely to be significant merit in including the contractual trigger features in a single 'umbrella' agreement, covering all the relevant internal MREL instruments. This approach has the benefit of providing greater simplicity, transparency and assurance on the circumstances under which a group's internal MREL or equivalent instruments in other jurisdictions will be written-down and/or converted.

2.17 The responsibility for ensuring that instruments, including own funds instruments, are MREL eligible rests with the firm.

Figure 1 Summary of internal MREL calibration and transition ^{(a)(b)}

Internal MREL for material subsidiaries and sub-groups of:	1 January 2019	1 January 2020	1 January 2022 (subject to review)
G-SIBs	(16% RWA or 6% LR) x scalar	$([2xP1]+[1xP2A])$ or 2 x LR if applicable and at least 6% x scalar	$(2x[P1+P2A])$ or 2 x LR if applicable and at least 6.75% x scalar
D-SIBs	Equal to regulatory capital requirements	$([2xP1]+[1xP2A])$ or 2 x LR if applicable x scalar	$(2x[P1+P2A])$ or 2 x LR if applicable x scalar
Other bail-in firms	Equal to regulatory capital requirements	18% RWA x scalar	$(2x[P1+P2A])$ or 2 x LR if applicable x scalar
Partial transfer	Equal to regulatory capital requirements	18% RWA x scalar	$(2x[P1+P2A])$ or 2 x LR if applicable x scalar*
Modified insolvency (does not have material subsidiaries or sub-groups)	Equal to regulatory capital requirements	Equal to regulatory capital requirements	Equal to regulatory capital requirements

*Note: may be further adjustment to reflect the resolution strategy.

(a) 'Scalar' refers to the 75%–90% scaling adjustment that the Bank proposes to apply to the MREL calibration that would otherwise apply. This scalar may be 100% for groups with a simple structure.

(b) 'LR' refers to the leverage ratio requirement.

Transitional arrangements for internal MREL

(1) Under sections 6A and/or 12A of the Banking Act.

2.18 The Bank will retain the approach to the transitional arrangements for internal MREL that was proposed in the CP. These are summarised in **Figure 1**. The Bank may on a firm-specific basis set an earlier compliance date during the transitional period for interim and/or end-state external or internal MREs greater than capital requirements, for example where the Bank has concerns about the resolvability of a firm, or to implement international standards.

Loss-absorbing capacity for operational continuity

2.19 The CP proposed that critical service providers supporting the delivery of the group's critical functions must maintain financial resources equivalent to at least 25% of the annual operating costs of providing services. Having considered the consultation responses and reflected further on possible alternatives, the Bank has decided not to take forward this approach and this requirement has been removed from the SoP. The Bank intends to review in more detail the costs and benefits of pre-positioning a fixed amount of loss-absorbing capacity for operational continuity within the service provider against alternative approaches. The PRA's expectations (SS9/16) on financial resources for operational continuity are unaffected.

2.20 It remains the case that firms should consider what financial resources are needed to allow continuity of provision of critical services to receiving entities, during stress or resolution and after resolution, as part of the post-resolution restructuring of any group entities (PRA SS9/16). The Bank expects to clarify its approach to loss-absorbing capacity for operational continuity at a later date, in consultation with the PRA.

External MREL for banking groups with MPE resolution strategies

2.21 The Bank will retain the approach to the external MREL for banking groups with MPE resolution strategies that was proposed in the CP. The Bank is confirming that in the calculation of the group consolidated MREL for MPE groups, the 'sum of requirements' is the sum of the binding MREs (or equivalent requirements) or capital requirements for each of the resolution groups or other entities or sub-groups outside these resolution groups.

Other changes to the MREL Statement of Policy

2.22 In updating the SoP for internal MREL, the Bank is also taking the opportunity to clarify other parts of the text in a small number of areas.

External MREL instrument eligibility

2.23 In the CP, the Bank expressed the view in respect of external MREL instruments that 'the failure to meet the eligibility criteria... in both non-CET1 own funds instruments and MREL eligible liabilities is likely to constitute an impediment to successful resolution, as the resolution authority must have certainty as to the quantum of loss-absorbing capacity that will be available should the institution find itself in stress.'

2.24 The Bank notes that firms should consider whether having non-CET1 own funds instruments that do not meet the eligibility criteria, as described above, could create difficulties for resolution. The resolution authority will want assurance about the quantum of loss-absorbing capacity that will be available should the institution find itself in stress. In cases (either outside or in the course of

resolution proceedings) where it is not possible to write-down and/or convert the non-CET1 own funds instruments to CET1 using statutory powers⁽¹⁾, for example instruments governed by non-EEA law where there is no statutory or contractual recognition of UK bail-in rules, the Bank could determine that it needs to use its powers under section 3A of the Banking Act to direct relevant persons to address impediments to resolution, in particular through a direction to endeavour to renegotiate instruments under section 3A(4-5). The Bank may consider the challenges to resolvability presented by such instruments as part of assessing firms' resolvability.

Statutorily subordinated external MREL instruments

2.25 In the CP, the Bank proposed that internal MREL could be met using statutorily or contractually subordinated eligible liabilities, as well as own funds instruments. The Bank is retaining this approach.

2.26 The Bank notes that building societies may use statutorily subordinated eligible liabilities, as well as contractually subordinated eligible liabilities and own funds instruments, to meet external MREL. The use of statutorily subordinated eligible liabilities will be subject to the date of the expected transposition of the EU Bank Creditor Hierarchy Directive (2017/2399) in the UK, which creates a new class of non-preferred senior debt that should rank in insolvency above own funds instruments and subordinated liabilities that do not qualify as own funds instruments, but below other senior liabilities.

2.27 The Bank is also confirming, for the avoidance of doubt, that for all other firms that use structural subordination to meet external MREL, these structurally subordinated instruments may also be statutorily or contractually subordinated if the firm wishes.

Clean holding company requirements

2.28 The Bank is clarifying that the clean holding company requirements described in 6.3 of the SoP will apply from 1 January 2022. Before that date, firms are expected to make progress towards meeting the clean holding company requirements and may be asked to discuss their plans to achieve this with the Bank and the relevant competent authority (the PRA or the FCA).

2.29 The Bank is further clarifying, consistent with the MREL RTS, that – in addition to the requirement that the sum of a resolution entity's liabilities that do not qualify as MREL should not exceed 5% of the resolution entity's overall external MREL resources – the sum of those liabilities that do not qualify as MREL in each creditor class should not exceed 10% of the resolution entity's MREL resources in that same creditor class. This is to limit the risk in resolution that creditors could be left worse off than under insolvency.

Other issues regarding the Bank's policy approach to MREL

2.30 The Bank will retain the approach to other issues regarding the Bank's policy approach to MREL that was proposed in the CP.

Restrictions on firms' ability to hold each other's MREL

(1) Under sections 6A and/or 12A of the Banking Act

2.31 In the European Union, the European Commission has proposed amendments to the CRR which would require EU G-SIBs to deduct MREL they hold issued by other G-SIBs from their own MREL resources. Though narrower in scope, this intended to implement the Basel Committee on Banking Supervision's standard on TLAC holdings ('the BCBS standard'). The Bank expects to clarify its policy proposals for MREL deductions, once there is greater clarity as to the timing and final content of the EU proposals.

Disclosure of MREL resources by firms

2.32 In the European Union, the European Commission has proposed to introduce MREL disclosure requirements through amendments to the CRR (for G-SIBs) and the BRRD (for other firms). The timing and scope of the amendments are uncertain. The Bank therefore expects to set out its policy on MREL disclosure, once there is greater clarity as to the timing and final content of the EU proposals. In the meantime, the Bank is exploring the scope for voluntary disclosure by UK G-SIBs and D-SIBs in line with the BCBS Pillar 3 standard, with the expectation that these would take place from 2019.

MREL reporting

2.33 The PRA (CP1/18) set out for consultation in January its proposed expectations for reporting on the minimum requirement for MREL through updates to Supervisory Statement (SS) 19/13 'Resolution planning'. The PRA has now published its expectations for MREL reporting through updates to Supervisory Statement (SS) 19/13 on 'Resolution planning'.⁽¹⁾

(1) Available at <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/resolution-planning-ss>.

3 Feedback on consultation

Scope of internal MREL

3.1 Respondents were broadly supportive of the proposed criteria for identifying material subsidiaries that are in scope of internal MREL above capital requirements. Some responses noted that the Bank should try to ensure a level-playing field with the scope of internal MREL that will be applied in EU jurisdictions once revisions to BRRD are finalised.

3.2 The Bank's view is that it is important to ensure that the financial resources needed to absorb losses are appropriately distributed within the group to maintain critical functions. As noted in paragraph 9.5 of the SoP, the Bank will review its MREL policy before the end of 2020, having regard to any intervening changes in the UK regulatory framework.

3.3 Some respondents cautioned that branches should not be subject to internal MREL beyond any requirement that applies to the legal entity which they are part of, consistent with the FSB Principles.

3.4 The Bank does not propose to set internal MREL for branches and the Banking Act does not currently provide for this. The Bank will engage with the home authority where it has concerns about the group resolution plan covering a branch of a foreign bank that operates in the United Kingdom and which performs critical functions.

3.5 Some respondents noted concerns, such as extra reporting, that could materialise if the Bank required a sub-consolidated balance sheet to be drawn up for the purposes of setting internal MREL, where there is no prudential sub-consolidation.

3.6 The Bank recognises these concerns, but nevertheless thinks it is important that it reserves the right to require an institution to draw up a sub-consolidated balance sheet, where there is no prudential sub-consolidation. Such circumstances might arise, for instance, if the material subsidiary owned a group of subsidiaries that did not meet the conditions for internal MREL themselves but together constituted a significant proportion of the group's risk-weighted assets.

Calibration of internal MREL

3.7 Respondents were broadly supportive of the Bank's proposed approach to setting internal MREL. Respondents generally favoured scaling internal MREL at the lower end of 75% to 90% range. Some were concerned that, if other authorities chose to scale internal MREL at the upper end of the range in their jurisdictions, then under the Bank's proposed scaling criteria – credibility of the resolution plan, availability of resources within the group, and scaling applied by other jurisdictions – this could lead the Bank to also scale internal MREL towards 90%.

3.8 The Bank's view is that the approach proposed in the CP ensures consistency with international standards, in particular the FSB's TLAC standard, and provides clarity and comfort that there is loss-absorbing capacity to maintain critical functions at material subsidiaries. Through scaling internal

MREL, there is more likely to be a surplus of external MREL over the sum of internal MREL which can be made readily available to support failing subsidiaries if pre-positioned internal MREL resources are not sufficient. This can bolster the overall resolvability of the group. The Bank will discuss the calibration of internal MREL with other authorities in CMGs, resolution colleges, or other forums as appropriate, taking into account the relationship with surplus MREL and the credibility of the resolution plan more broadly.

3.9 Respondents were generally supportive of the Bank's proposed approach to avoiding double counting of MREL resources in groups. Some respondents asked for clarification that the approach factored in the existing own funds deductions for investments in the own funds instruments of subsidiaries; this has now been clarified in the SoP.

3.10 Some respondents also asked whether investments in internal MREL will be deducted from RWAs and leverage exposures, in line with the FSB's Principles. The Bank notes that this treatment already applies to own funds instruments, where there are deductions for investments in own funds instruments of subsidiaries. The RWA and leverage treatment of investments in internal MREL eligible liabilities may be affected by the outcome of EU negotiations to update the EU prudential and resolution frameworks and the Bank will continue to engage with the PRA on this issue.

3.11 Some respondents noted that they supported the PRA's proposal to exempt internal MREL from large exposures limits, as set out in the consultation (CP20/17). The Bank will continue to engage with the PRA to ensure that the interaction between MREL and the framework on large exposures is managed appropriately.

MREL surplus

3.12 Respondents asked for further clarity on the Bank's proposals on MREL surplus: some stated that MREL surplus should not become a requirement in itself and others invited the Bank to specify when resources should be considered readily available.

3.13 Other respondents highlighted some challenges associated with investing the surplus in high-quality liquid assets at the resolution entity level. In particular, according to the respondents, such an arrangement may have an adverse impact on their credit rating, their ability to comply with clean holding company requirements and their profitability.

3.14 Respondents also remarked that MREL surplus invested in high-quality liquid assets would not be eligible for Liquidity Coverage Ratio purposes and questioned whether it could be held in a different form. Others set out the benefits of prepositioning MREL surplus in material subsidiaries, rather than at the resolution entity.

3.15 Surplus will continue to be a relevant factor in determining internal MREL. While some pre-positioning of loss-absorbing capacity at material subsidiaries can provide clarity and comfort that critical functions will be preserved, having some resources that can easily be transferred within a group and deployed where needed can reduce the amount of pre-positioning that authorities judge is necessary. Greater surplus is also likely to enhance the resilience of the group.

3.16 The Bank has decided not to set requirements around the location and the form of surplus MREL at this stage. The Bank thinks it is appropriate to consider in more detail the issues relating to

surplus MREL, in consultation with other authorities in CMGs, and will review its approach as part of assessing firms' resolvability. The Bank therefore expects to clarify its approach to surplus MREL at a later date.

Ring-fenced bodies and UK groups with simple structure

3.17 Some respondents suggested that the proposed internal MREL calibration for the top entity of ring-fenced body sub-groups was too high: the proposed scaling of 90% as a starting point, unless the Bank is satisfied that the wider group has sufficient readily-deployable resources to justify moving to a lower calibration in the 75% to 90% range, was seen as inconsistent with the general policy principles adopted by the Bank.

3.18 The Bank considers 90% scaling for the top-entity in RFBs consistent with the general approach of scaling internal MREL for material subsidiaries in the range of 75% to 90%. In addition, this approach is aligned with the FSB's TLAC standard as well as with the PRA ring-fencing objectives, through minimising the RFB's dependence on the rest of the group. The Bank is committed to working with overseas resolution authorities to build confidence in each other's resolution regimes. This could help contribute towards circumstances in which this scaling can be reduced in the future.

3.19 Some respondents also asked for clarifications about when the 100% scaling for UK groups with a simple structure will apply and enquired whether a material sub-group including a RFB and a NRFB may also be in scope of this higher MREL calibration.

3.20 The Bank's approach will be judgement-based, and decided on a case-by-case basis, giving due consideration to the relationship between the risk profile of a material subsidiary and its wider group. As noted in the consultation, an example of a simple structure would be a single material subsidiary that sits below a UK resolution entity with few, if any other, subsidiaries. Scaling down internal MREL in this situation could otherwise simply result in the externally issued MREL being used to fund the material subsidiary in a form that was not eligible for internal MREL. The Bank notes that it reserves the right to take appropriate steps using its statutory powers to ensure that MREL is distributed within groups in such a way as to support the group resolution strategy, including, in the case of MPE firms, so as to ensure that a resolution group has sufficient MREL to be self-sufficient in resolution.

UK subsidiaries of foreign groups and non-UK subsidiaries of UK groups

3.21 Some respondents asked the Bank to clarify how it will communicate and co-operate with overseas home and host resolution authorities in defining, respectively, the internal MREL for UK subsidiaries of foreign groups and for non-UK subsidiaries of UK groups. Some respondents also expressed concerns that non-UK subsidiaries of UK groups could have to keep more internal loss-absorbing capacity than the host authority had deemed appropriate.

3.22 The Bank confirms that it will use CMGs, resolution colleges, and other forums to engage with overseas authorities and reach a joint decision on internal MREL. The Bank expects to propose a quantum of internal MREL for non-UK subsidiaries of UK groups, where the host authority has not published regulations or regulatory proposals. This is not intended to substitute for or override hosts' discretion to calibrate internal MREL for material subsidiaries in their jurisdiction, but supports discussions around the resolvability and availability of resources within the group by

ensuring that all material subsidiaries have some pre-positioned internal MREL above capital requirements, while all jurisdictions develop their approach in this area. This will ensure that the calibration of internal MREL is agreed by the relevant authorities, where possible, and that no impediment to resolvability arises.

Internal MREL instrument eligibility

3.23 Respondents broadly agreed with the Bank's proposed policy on internal MREL instrument eligibility, subject to some concerns noted below.

Holder of the instrument

3.24 Respondents broadly supported the possibility for subsidiaries to issue internal MREL to the resolution entity directly or indirectly. However, some argued that subsidiaries should also be allowed to issue instruments outside of their group, as external issuance may not represent an impediment to resolvability.

3.25 The Bank intends to proceed with the requirement that eligible liabilities issued by non-resolution-entity subsidiaries will only count towards internal MREL if issued internally within the group that the subsidiaries belong to, as any different arrangement may result in a change in the control of the subsidiary and/or create barriers to the write-down or conversion of the instruments to provide for loss absorption and recapitalisation at the group level.

3.26 Where own funds instruments issued externally by a non-resolution entity subsidiary count towards that subsidiary's individual capital requirement, under BRRD such instruments can count towards that subsidiary's individual internal MREL. The FSB's TLAC standard provides that such externally issued non-CET1 own funds instruments should not count towards internal TLAC from 1 January 2022. The Bank is clarifying that, whether or not this restriction is adopted through the revision of CRR and BRRD, firms should consider whether the conversion to CET1 of externally issued non-CET1 own funds instruments counting towards MREL could lead to a change in control of a subsidiary. The Bank may consider any challenges to resolvability presented by such instruments as part of assessing firms' resolvability. The existence from 1 January 2022 of outstanding non-CET1 own funds instruments issued from non-resolution entity subsidiaries to holders outside the group, that are counted as MREL, may lead the Bank to set higher end-state MREL to compensate for those issuances.

Contractual triggers

3.27 Respondents expressed some reservations about the Bank's proposal to include contractual triggers in internal MREL instruments. Some respondents questioned the need for contractual triggers, noting that the Bank has statutory powers to write-down and/or convert own funds instruments and it is currently expected that the Bank will acquire this power also for internal MREL eligible liabilities, due to the forthcoming amendments to the EU prudential and resolution frameworks. Some respondents questioned whether triggering instruments issued by a subsidiary, due to the resolution of a parent entity, would be proportionate. Other respondents pointed out that contractual triggers are not required by the FSB Principles.

3.28 The Bank considers that contractual triggers play an important role in ensuring that internal MREL instruments can be used to absorb losses and recapitalise material subsidiaries in a way that supports the resolution strategy. The Bank does not currently have a statutory power to write-down and/or convert internal MREL eligible liabilities without using resolution tools – this means that the Bank would need to put a material subsidiary into resolution in order for these instruments to absorb losses, which would be inconsistent with the resolution strategy and therefore could have a destabilising impact on the subsidiary and the wider group. Contractual triggers overcome this issue. In addition, the Bank’s view is that contractual triggers provide for co-ordination between resolution authorities, through requiring the home authority’s consent or non-objection to trigger the instrument without using resolution tools, consistent with the FSB’s TLAC standard.

3.29 The contractual trigger also provides for the write-down and/or conversion of internal MREL instruments, when a resolution entity in the group is subject to resolution proceedings – even if the subsidiary is not yet failing or likely to fail and unable to recover. Having the ability to strengthen the capital position of a material subsidiary in these circumstances would not create any extra losses for the subsidiary or the group, but changes the form of some of the instruments from debt liabilities to equity at the subsidiary and also potentially at the resolution entity. The ability to co-ordinate this further capitalisation of material subsidiaries can support greater market confidence in the group and its subsidiaries following resolution, given that they will be better capitalised, and should reduce the need to carry out further write-downs in the weeks following entry into resolution.

3.30 The Bank therefore expects that eligible liabilities issued by material subsidiaries will include such contractual triggers. In relation to non-CET1 own funds instruments, firms should consider that the absence of such contractual triggers in non-CET1 own funds instruments could create difficulties for resolution. In cases (either outside or in the course of resolution proceedings) where it is not possible to write down and/or convert the non-CET1 own funds instruments to CET1 using statutory powers⁽¹⁾, for example instruments governed by non-EEA law where there is no statutory or contractual recognition of UK bail-in rules, the Bank may use its powers under section 3A of the Banking Act to direct relevant persons to address impediments to resolution, in particular through a direction to endeavour to renegotiate instruments under section 3A(4-5). The Bank may consider the challenges to resolvability presented by such instruments as part of assessing firms’ resolvability.

3.31 Some respondents noted that the Bank’s 24-hour period for notifying and seeking the consent or non-objection of overseas authorities for triggering the internal MREL instruments was shorter than the 48-hour period mentioned in the FSB Principles. In the Bank’s view, however, resolution authorities will aim to co-ordinate and share information well ahead of any potential resolution, in accordance with the FSB Principles, and should be well prepared to take actions quickly, when needed to execute the resolution plan.

3.32 Some respondents expressed concerns that internal MREL instruments including a contractual trigger may give rise to tax and accounting issues, for instance as a result of the assessment at fair value of instruments with contractual write-down clauses, according to IFRS9. HMT and HMRC have engaged with industry representatives since the close of the consultation, in conjunction with the Bank, and are continuing to engage on this.

(1) Under sections 6A and/or 12A of the Banking Act

3.33 As regards the accounting concerns raised by some respondents, the Bank understands that instruments that include contractual triggers may need to be assessed at fair value rather than on an amortised cost basis, when held as an asset at the parent entity, and that the accounting treatment of such instruments may vary in different jurisdictions. The Bank reminds firms that adherence to accounting standards and practices is a firm responsibility; therefore each group will need to consider the impact of contractual triggers on the valuation of internal MREL instruments.

Mismatching of internal and external MREL

3.34 Some respondents expressed concerns about the Bank's proposal to periodically review the extent to which internal MREL resources of a material subsidiary differ in form from the MREL issued externally from the resolution entity, where this may pose risks to the resilience and resolvability of the group. These respondents pointed out that eligibility criteria in different jurisdictions and market conditions may create unavoidable mismatches in the nature and structure of instruments. Some respondents also questioned how the Bank's approach to mismatches would relate to the PRA's policy on double leverage (PS9/18). In addition, some respondents thought that the Bank's proposal, that firms should not change the form of their internal MREL resources in a way that reduces the amount of MREL eligible liabilities unless the Bank approves the transaction, seemed overly restrictive.

3.35 The Bank maintains the view that it is important for institutions to consider whether differences in the form of internal and external MREL are likely to reduce the resolvability and resilience of a group, especially where the resolution entity may rely on dividend payments in order to service externally or internally issued debt. As noted in the CP, the Bank will consult with the PRA on any actions that the Bank proposes to take in this regard and will take into account the reasons behind the mismatch and the consequences of removing them. This will help to coordinate any resolvability concerns that the Bank may have with any PRA prudential concerns, particularly in view of its policy on double leverage.

3.36 The Bank will allow firms to make use of indirect structures, but reserves the right to require firms to demonstrate that such structures do not present legal or operational constraints to the recapitalisation of material subsidiaries and, more broadly, the resolution strategy.

3.37 The Bank's view is that changes in the form of internal MREL, consistent with 3.35 above, may affect the resolvability and resilience of a group. Therefore firms should notify the Bank if they expect there to be any material change in the form of their internal MREL resources. Firms should not change the form of their internal MREL resources in a way, such as through cancellation or conversion to CET1, that reduces the amount of MREL eligible liabilities unless the Bank approves such a transaction.

Transitional arrangements for internal MREL

3.38 Some respondents commented on the transitional arrangements for internal MREL, expressing general support for the policy and enquiring how the Bank will liaise with overseas authorities in order for requirements to apply to G-SIBs from January 2019.

3.39 The Bank continues to co-operate with overseas resolution authorities to ensure that the FSB Principles are adhered to globally. The Bank will therefore retain the approach proposed in the CP.

3.40 Some respondents asked for further information about the consequences of breaches of internal MREL. The PRA's policy for dealing with breaches of MREL is covered in SS16/16. It applies where the Bank as resolution authority has set an MREL higher than the firm's minimum capital requirements, which would include both an internal MREL and an external MREL. In addition, firms should be mindful of 'The PRA's approach to banking supervision'⁽¹⁾, which notes that 'The PRA expects firms to meet its expectations on both a consolidated basis for groups headquartered in the United Kingdom, for UK subgroups of wider global groups, and at the level of regulated legal entities. A regulated firm's relationships with other entities in the group may affect its prudential soundness, for example through access to capital, intra-group exposures or contagion.'

Loss-absorbing capacity for operational continuity

3.41 Respondents welcomed policy development around loss-absorbing capacity for operational continuity of critical service providers; however they questioned the scope, calibration and timing of the proposed requirements, as well as their interaction with the existing liquidity and capital frameworks related to operational continuity.

3.42 According to the respondents, the approach proposed by the Bank may result in duplicative requirements, as some firms would have to maintain loss-absorbing capacity for operational continuity above and beyond any internal MREL. Some respondents also highlighted that such policy may distort the allocation of critical functions within and outside groups, by incentivising some business models over others.

3.43 Other respondents asked the Bank to justify the 25% calibration proposed in the CP and suggested the deduction of costs unrelated to the provision of critical services from the total operating costs used to determine the requirement. Some respondents also asked the Bank to clarify how it would ensure compliance for service providers based in other jurisdictions.

3.44 Following the review of the consultation responses, the Bank has decided not to apply the approach to loss-absorbing capacity for operational continuity that was proposed in the CP. The Bank thinks it is appropriate to review the issue in more detail, in consultation with the PRA. See paragraphs 2.19-2.20 above for further details.

External MREL for banking groups with MPE resolution strategies

3.45 Whereas respondents broadly agreed that MREL calibration should not depend on whether a group resolution strategy is SPE or MPE and should be consistent with the FSB's TLAC standard, there were some differences in view on the Bank's approach to setting external MREL for groups with an MPE strategy.

3.46 Some respondents were concerned that the external MREL applying to an MPE consolidated banking group could be lower than for an SPE group. The group consolidated end-state MREL applying to the ultimate parent entity of a MPE group should reflect the higher of: (i) 18% of RWAs; (ii) 6.75% of leverage exposures on a consolidated basis; and (iii) the sum of requirements relating to

(1) Also referred to as the 'approach document', March 2016; www.bankofengland.co.uk/news?NewsTypes=65d34b0d42784c6bb1dd302c1ed63653&Taxonomies=973f7bc68fd74abca30287f8a0a15fa3&Direction=Latest.

each of its resolution groups and entities or sub-groups located outside these resolution groups. Others pointed out that this could lead instead to a higher MREL for MPE banking groups, as intra-group exposures would not be deducted from the sum of the requirements for each of the resolution entities, whereas these are excluded from consolidated requirements for groups with a SPE resolution strategy.

3.47 The Bank views its approach as being aligned with international standards, taking appropriate account of differences in resolution strategies, and ensuring a level-playing field for all institutions. The proposals set out in the CP, therefore, have not been amended, with the exception of clarifying that the sum of requirements includes capital requirements that apply to entities or sub-groups that are located outside the resolution groups.

Other issues regarding the Bank's policy approach to MREL

Restrictions on firms' ability to hold each other's MREL

3.48 Respondents supported 'like-for-like' deductions of MREL cross-holdings, i.e. that an institution should deduct holdings of other institutions' MREL from its own MREL resources. The BCBS standard requires internationally active banks to deduct holdings of non-capital TLAC from their Tier 2; however respondents argued that this was due to the assumption that only some institutions would be required to issue TLAC, whereas all institutions are required to meet MREL.

3.49 Considering the ongoing discussion of amendments to EU legislation that may introduce a MREL cross-holdings' deductions regime in the CRR, the Bank decided it will publish further policy proposals once there is greater clarity on the scope and timing of any EU requirements.

Disclosure of MREL resources by firms

3.50 Respondents would welcome further clarity on MREL disclosure; however they support the Bank's proposal to set out its policy, once the disclosure requirements that will be introduced by amendments to the CRR and BRRD are defined.

3.51 Respondents also underlined that, in the absence of a harmonised EU framework, benefits of disclosure for investors would be limited by the lack of comparability and asked the Bank to avoid imposing an unnecessary burden, in light of other disclosure and reporting obligations that are being or will be introduced in the next few years.

3.52 The Bank considers that the approach set out in the CP remains appropriate. In particular, in the absence of EU binding requirements, the Bank will explore whether a voluntary disclosure framework may be introduced for UK G-SIBs and D-SIBs from 2019, in line with the BCBS Pillar 3 standard.

MREL reporting

3.53 Some respondents noted that the application date of any EU reporting regime is uncertain and therefore suggested that the PRA should wait until EU legislation is finalised before introducing any reporting framework. One respondent also urged the Bank to cooperate with other authorities so

that any data requested is submitted only once, through automated processes (where possible) and avoiding duplications and collection of unnecessary data.

3.54 The Bank agrees that cooperation with the PRA and overseas authorities is an important factor for reporting regimes; however it believes that expectations on MREL reporting need to be clarified in order to allow for more time for institutions to comply with the new regime.

3.55 The PRA has now published its expectations for MREL reporting through updates to Supervisory Statement (SS) 19/13 on 'Resolution planning'.⁽¹⁾

(1) Available at <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/resolution-planning-ss>.

4 Next steps

Interaction with institutions

4.1 The Bank intends to communicate to institutions the following:

- in 2018 H2, the interim internal MREL which the Bank expects to apply from 1 January 2019 for relevant subsidiaries of G-SIBs, subject to an EU joint decision for relevant subsidiaries on the basis of the Bank's SoP; and
- in early 2019, the interim internal MREL which the Bank expects to apply from 1 January 2020 for relevant subsidiaries of non-G-SIBs, subject to an EU joint decision process for relevant subsidiaries on the basis of the Bank's SoP.

4.2 MREL including internal MREL must be set on an annual basis. The Bank will engage with institutions at this time, as well as on an ongoing basis, to consider whether the transitional arrangements for meeting the interim or end-state MREs remains appropriate.

Legislative obligations

4.3 The Bank has given careful consideration to all responses received and intends to continue to engage with institutions as it performs its statutory functions in relation to resolution.

4.4 The Bank will keep the SoP under review and update it where necessary. In particular the Bank will review the calibration of MREL and the final compliance date prior to setting end-state MREs and, in any case, before the end of 2020. In doing so, the Bank will have particular regard to any intervening changes in the UK regulatory framework, including due to the revision of BRRD and CRR, as well as firms' experience in issuing liabilities to meet their interim MREs.

Appendix

1 Statement of Policy on the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

Available at: <https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/statement-of-policy-boes-approach-to-setting-mrel-2018>