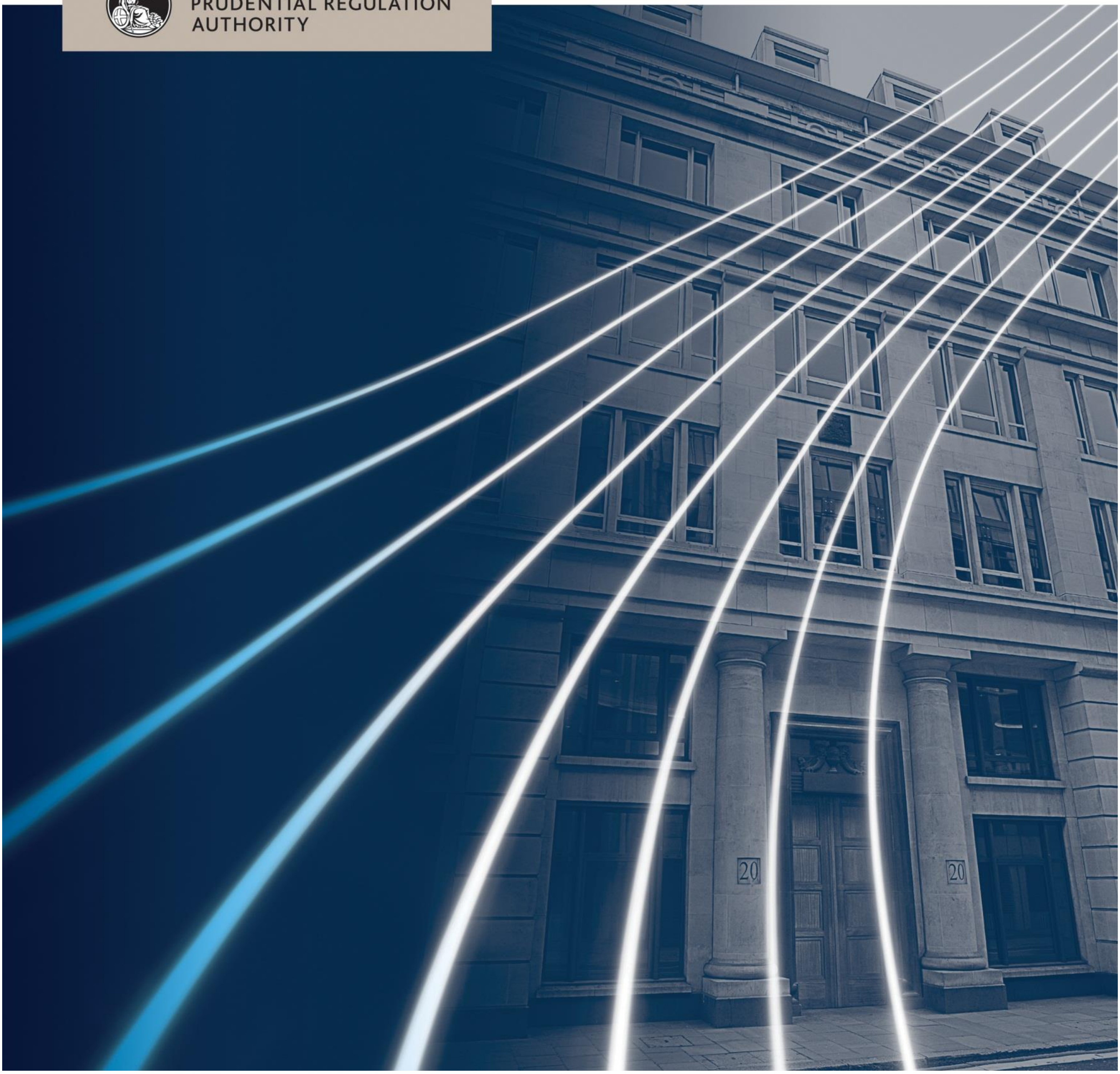
Policy Statement | PS30/16

The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions

November 2016

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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This Policy Statement (PS) provides feedback on responses received to Consultation Paper (CP) 44/15 'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions'. The appendix to this PS sets out the final Supervisory Statement (SS) 16/16 on the relationship between MREL and buffers, and MREL and Threshold Conditions.

Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback on responses to Consultation Paper (CP) 44/15 'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions'[1] and sets out the final Supervisory Statement (SS) 16/16 on the relationship between MREL and buffers, and MREL and Threshold Conditions.

1.2 This PS is relevant to all PRA-regulated banks, building societies and PRA-designated investment firms (firms). Alongside this PS, the Bank of England (the Bank) has published a statement of policy on its approach to setting MREL in line with relevant legislation.[2] Readers should consider the PRA's PS in light of the Bank's statement of policy and vice versa.

1.3 The policies contained in this PS have been developed in the context of the current UK and EU regulatory framework. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework, including changes arising once any new arrangements with the European Union take effect.

1.4 In CP44/15, the PRA proposed that:

- firms should not double count common equity tier 1 (CET1) capital towards, on the one hand, MREL, and, on the other, risk-weighted capital and leverage buffers ('MREL buffer policy'); and

- firms in breach of MREL should expect the PRA to investigate whether the firm is failing, or likely to fail, to satisfy the Threshold Conditions with a view to taking further action as necessary ('Threshold Conditions policy').

1.5 The PRA has had regard to representations made to the proposals in the consultation. It is now publishing an account, in general terms, of those representations and its response to them, as well as details of any significant differences from the proposals.

1.6 In the PRA's opinion, the impact on mutuals of the policies set out in the final SS is not significantly different from the impact on mutuals of the proposals consulted on in CP44/15.

1.7 The PRA received nine responses to CP44/15. Overall, the PRA does not consider that the responses require significant changes to its proposals. The PRA has made two amendments to the draft SS to provide further clarity to firms. The amendments concern the entry into force of the proposed policies and the relationship between the MREL buffer policy and restrictions on distributions. Chapter 2 explains these changes and provides several further minor clarifications in light of feedback received.

1 December 2015; www.bankofengland.co.uk/pra/Pages/publications/cp/2015/cp4415.aspx.
2 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL): Responses to Consultation and Statement of Policy', November 2016; www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf.

2 Responses to feedback

2.1 This chapter sets out clarifications on CP44/15 in light of feedback received during consultation.

Transitional arrangements

2.2 Respondents asked when the MREL buffer and the Threshold Conditions policies would enter into force.

2.3 In the statement of policy on its approach to setting MREL, the Bank, as UK resolution authority, indicates that it expects to direct firms to comply with an end-state MREL from 1 January 2022. To ensure that firms make progress towards meeting their end-state requirements, the Bank expects to direct relevant firms to also meet an interim MREL. Please refer to Chapter 7 of the Bank statement of policy for these transitional arrangements.

2.4 The PRA will apply the MREL buffer and Threshold Conditions policies in respect of MREL set by the Bank with respect to both interim and end-state requirements.

2.5 If a firm expects that it will not meet its interim or end-state MREL at the end of the relevant transitional period it should notify the PRA promptly and should expect the PRA to investigate whether the firm is failing, or likely to fail to satisfy Threshold Conditions with a view to taking further action as necessary. However, a firm being likely to not meet its interim or end-state MREL at the end of the relevant transitional period will not automatically mean the PRA will consider the firm is failing or likely to fail to meet Threshold Conditions. The PRA will have to assess the situation at the time.

2.6 If a firm expects that it will not have sufficient CET1 to meet its interim or end-state MREL and its buffers at the end of the relevant transitional period, it should notify the PRA promptly. The PRA may consider requiring the firm to take steps to strengthen its capital position.

The relationship between the MREL buffer policy and restrictions on distributions

2.7 Respondents asked how the MREL buffer policy interacts with the maximum distributable amount (MDA) under the Capital Requirements Directive (2013/36/EU)(CRD).

2.8 The MREL buffer policy does not impact the automatic restrictions on distributions which apply under CRD IV.[1] Rule 4.3 in the Capital Buffers Part of the PRA Rulebook and firm-specific requirements,[2] transposing Article 141 of the CRD, require firms that fail to meet the CRD IV combined buffer requirement to calculate an MDA and notify the PRA of that MDA. Automatic restrictions on distributions will apply to firms that do not have sufficient CET1 to meet their individual capital guidance and the CRD IV combined buffer.

2.9 A firm that has insufficient resources to meet its MREL without double counting CET1 between MREL and buffers will not be subject to automatic restrictions on distributions. However, the firm can expect enhanced supervisory action and should prepare a capital restoration plan. The PRA has also made this clarification in paragraph 2.4 of SS16/16.

1 CRD and Capital Requirements Regulation (575/2013) (CRR) – jointly 'CRD IV'.

2 As stated in SS31/15 and SS6/14, PRA imposes requirements on firms under section 55M of the Financial Services and Market Act 2000 to set the Global Systemically Important Institutions buffer (where applicable) and preventing firms from meeting their CRD IV combined buffer with any CET 1 capital maintained to meet their individual capital guidance.

The application of the MREL buffers policy in groups

2.10 Respondents asked how buffers set at different levels of consolidation interact with MREL set at different levels of consolidation. Firms also asked whether a buffer that applied at the consolidated group level, such as the Global Systemically Important Institutions (G-SII) buffer, would be relevant for the MREL buffer policy at the level of the individual entity, which is not subject to such a buffer.

2.11 The MREL buffer policy applies at each level of application of prudential requirements within the group where the Bank as resolution authority has set an MREL higher than the firm's minimum capital requirements, ie at the consolidated level, the sub-consolidated (where applicable) and at the individual entity level. Given that the G-SII buffer applies only at the consolidated level, it does not impact the MREL buffer policy at the level of the individual entity.

2.12 Firms more generally asked for clarity on the interaction between capital consolidation at the group level and the setting of loss absorbing capacity at the level of the resolution group. The Bank as resolution authority expects to provide further detail on the scope of application of MREL within groups in due course, taking account of international standards. In so doing the Bank may revise the groups section of its MREL statement of policy.

Replenishing buffers

2.13 Respondents asked how quickly a firm that did not have sufficient resources to meet both MREL and its buffers would be expected to replenish its buffers.

2.14 The PRA cannot set out a general timeframe for replenishment, as this would depend on the specific situation.

Buffers in scope of the MREL buffers policy

2.15 Firms asked which buffers are in scope of the MREL buffer policy.

2.16 As set out in Chapter 2 of SS16/16, the policy applies both to buffers derived from the risk-weighted assets regime (the combined CRD IV buffer and the PRA buffer) and to buffers derived from the leverage ratio framework (the countercyclical leverage ratio buffer and the G-SII additional leverage ratio buffer, if applicable).

The interaction between the MREL buffer policy and the leverage ratio regime

2.17 Respondents questioned whether the MREL buffer policy should also apply to leverage ratio buffers, given that the leverage ratio framework does not apply to all firms at the moment and is still being developed at the international level.

2.18 The PRA has maintained its proposal in CP44/15. Firms will be expected not to count CET1 resources used to meet MREL to also meet a leverage ratio buffer.

2.19 The leverage ratio regime currently applies only to a subset of firms, namely PRA-regulated banks and building societies with total retail deposits equal to or greater than £50 billion on an individual or consolidated basis. The Financial Policy Committee intends to review progress made towards an international standard for a minimum leverage ratio requirement in 2017 and to consider the implications for the UK framework.[1]

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1 See 'Financial Stability Report', July 2015, www.bankofengland.co.uk/publications/Documents/fsr/2015/fsrfull1507.pdf.

2.20 Firms also asked the PRA to clarify whether the MREL buffer policy in relation to leverage buffers would apply to firms which are not subject to a leverage ratio minimum requirement.

2.21 The MREL buffer policy in relation to leverage buffers will apply to firms which are subject to a leverage ratio buffer requirement. If a firm is not subject to a leverage ratio buffer requirement at the time at which the MREL buffer policy comes into force, then the firm will not be subject to the MREL buffer policy in relation to leverage buffers.

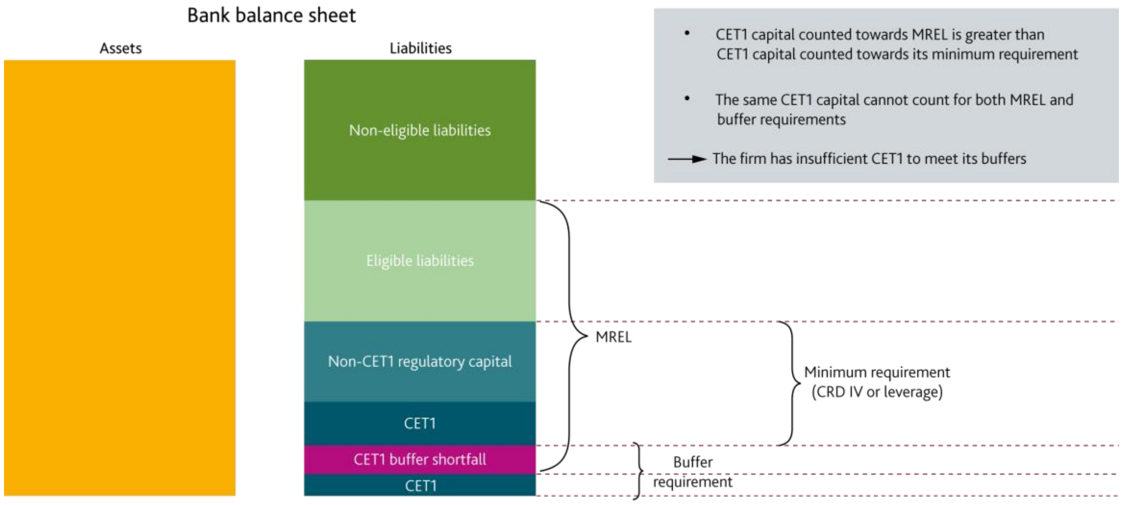
Diagrams to illustrate the MREL buffer policy

2.22 Respondents asked the PRA to elaborate on the MREL buffer policy and illustrate the policy with an example of a firm that is not using the same CET1 resources to meet MREL and its buffers and is therefore complying with the MREL buffer policy.

2.23 CP44/15 provided an example of a firm which is using the same resources to meet both MREL and its buffers. This is replicated in **Figure 1**.

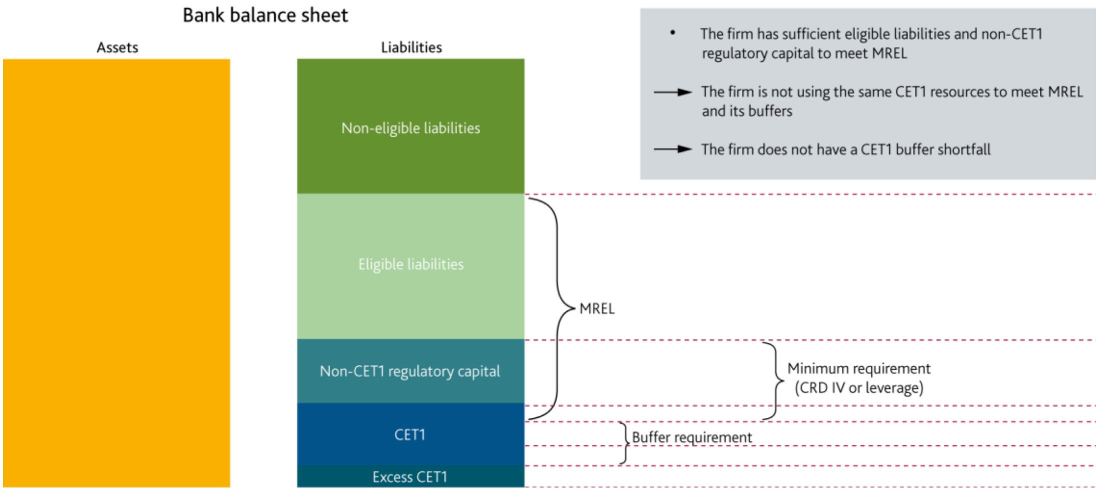
2.24 **Figure 1** considers a stylised balance sheet for a firm. In the example, the firm is meeting its minimum requirement (CRD IV or leverage) with CET1 and other non-CET1 regulatory capital. The firm is also meeting its MREL with eligible liabilities, non-CET1 regulatory capital and CET1. The firm in **Figure 1** is double counting the same CET1 between MREL and buffers (shown as the CET1 buffer shortfall). The PRA's MREL buffer policy prevents this, requiring the firm to change its balance sheet (most likely by increasing eligible liabilities) to ensure its buffer requirements are met.

Figure 1



2.25 The firm in **Figure 2** is complying with the MREL buffers policy. The firm in this example has more eligible liabilities than the firm in **Figure 1** as well as excess CET1. The firm can meet MREL without double counting CET1 resources used to meet its buffers.

Figure 2



The PRA's assessment of an MREL breach

2.26 Respondents asked for more clarity as to how breaches of MREL would be treated for systemic and non-systemic firms respectively. Firms also asked how breaches would be treated if firms can demonstrate that investor appetite is insufficient to enable MREL to be met at a reasonable cost.

2.27 The PRA's response to a breach, or a likely breach, of MREL and assessment against Threshold Conditions would depend on a supervisory judgement taken by reference to the relevant circumstances of the firm at that time.

2.28 As set out in CP44/15 and in line with the total loss absorbing capacity standard,[1] a breach or likely breach of MREL will be treated as seriously as a breach or likely breach of minimum regulatory capital requirements.

1 Financial Stability Board, 'Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet', November 2015; www.financialstabilityboard.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

Appendix

1 Supervisory Statement 16/16 'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions' available at www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss1616.aspx.