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BANK OF ENGLAND

June 2018

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

Statement of Policy

(updating November 2016)



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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 Background and statutory framework

1.1 This Statement of Policy is issued by the Bank of England (the Bank), as UK resolution authority, under section 3B(9) of the Banking Act 2009 as amended (the Banking Act). The Statement of Policy sets out how the Bank expects to use its power to direct a 'relevant person' to maintain a minimum requirement for own funds and eligible liabilities (MREL).

1.2 A 'relevant person' means:

- (a) an institution⁽¹⁾ authorised for the purpose of the Financial Services and Markets Act 2000 (FSMA) by the Prudential Regulation Authority (PRA) or Financial Conduct Authority (FCA);⁽²⁾
- (b) a parent of such an institution which (i) is a financial holding company or a mixed financial holding company; and (ii) is established in, or formed under the law of any part of, the United Kingdom; or
- (c) a subsidiary of such an institution or of such a parent which (i) is a financial institution⁽³⁾ authorised by the PRA or FCA; and (ii) is established in, or formed under the law of any part of, the United Kingdom.

1.3 The Bank is required to set MREL for all institutions. MREL must be set on both an individual institution and group consolidated basis. The Bank may set MREL for certain types of other relevant persons in an institution's group, specifically those entities listed under (b) and (c) above. As required by the Bank Recovery and Resolution (No. 2) Order 2014 (the No. 2 Order) the Bank will use its power of direction pursuant to section 3A(4) of the Banking Act to set MREL, in consultation with the PRA or FCA. References in this Statement of Policy to a 'group' means any group comprising one or more entities referred to in paragraph 1.2 above, whether established and authorised in the United Kingdom or elsewhere.

1.4 MREL must be set in line with the provisions of the No. 2 Order, the Bank Recovery and Resolution Directive (BRRD) and the European Commission Delegated Regulation (EU) 2016/1450 (the MREL RTS). The Bank will also consider the Financial Stability Board's total loss-absorbing capacity (TLAC) standard ('FSB TLAC standard') when setting MREL.

1.5 The No. 2 Order requires the Bank to set MREL on the basis of the following criteria, which are further specified in the MREL RTS:

- (a) the need to ensure that the institution can be resolved by the application of the stabilisation powers including, where appropriate, the bail-in tool, in a way that meets the resolution objectives;

- (b) the need to ensure, in appropriate cases, that the institution has sufficient eligible liabilities to ensure that, if the bail-in tool were to be applied, losses could be absorbed and the common equity Tier 1 (CET1) ratio of the institution could be restored to a level necessary to enable it to continue to comply with the conditions for authorisation and to continue to carry out the activities for which it is authorised under the Capital Requirements Directive 2013/36/EU (CRD4) or the Markets in Financial Instruments Directive 2014/65/EU (MiFID2) and to sustain sufficient market confidence in the institution or entity;
- (c) the need to ensure that, if the resolution plan anticipates that certain classes of eligible liabilities might be excluded from bail-in under article 44(3) of the BRRD or that certain classes of eligible liabilities might be transferred to a recipient in full under a partial transfer, the institution has sufficient other eligible liabilities to ensure that losses could be absorbed and the CET1 ratio of the institution could be restored to a level necessary to enable it to continue to comply with the conditions for authorisation and to continue to carry out the activities for which it is authorised under CRD4 or MiFID2;
- (d) the size, the business model, the funding model and the risk profile of the institution;
- (e) the extent to which the Deposit Guarantee Scheme could contribute to the financing of resolution in accordance with article 109 of the BRRD;
- (f) the extent to which the failure of the institution would have adverse effects on financial stability, including due to its interconnectedness with other institutions or with the rest of the financial system, through contagion to other institutions.

1.6 MREL is an institution-specific requirement, and the Bank will set MREL with the goal that individual institutions and groups can be resolved consistently with the resolution objectives under a preferred resolution strategy. This Statement of Policy describes the general framework the Bank will use when setting MREL, but is not definitive of any given relevant person's MREL.

(1) For the purposes of this Statement of Policy the term 'institution' means UK-incorporated banks, UK-incorporated building societies and those UK-incorporated investment firms that are required to hold initial capital of €730,000, in particular those that deal as principal. References in this Statement to an 'institution' shall, in general and unless otherwise stated, be taken to also include 'relevant persons'.

(2) The PRA and FCA are the UK competent authorities. According to article 2 of the Bank Recovery and Resolution Directive (2014/59/EU) and article 4 of the Capital Requirements Regulation (EU No. 575/2013), 'competent authority' means a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned.

(3) The term 'financial institution' has the meaning given by article 4 (1) (26) of Regulation 575/2013/EU.

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1.7 Where an institution has significant branches or subsidiaries in one or more European Economic Area (EEA) states, its MREL may be subject to joint decision in a resolution college. MREL determined in line with this Statement of Policy would be the Bank's preferred outcome of that joint decision process.

Interaction of MREL and the capital framework

1.8 The PRA has published a supervisory statement on the interaction of MREL and the capital framework.⁽¹⁾ The statement sets out the PRA's approach to:

- (a) the interaction of MREL and the capital framework; and
- (b) the interaction of MREL and the PRA Threshold Conditions.

1.9 Please consult the PRA's supervisory statement for further details.

2 Definitions and interpretation

2.1 'Own funds' has the same meaning as in article 4(1)(118) of Regulation 575/2013/EU (CRR).

2.2 'Own funds instruments' has the same meaning as in article 4(1)(119) of the CRR.

2.3 'MREL eligible liabilities' means eligible liabilities as defined in the Banking Act 2009 which meet the MREL eligibility criteria set out in this Statement of Policy.

2.4 There are two categories of MREL referred to in this document: 'external MREL' and 'internal MREL'.

2.5 External MREL instruments are issued from a 'resolution entity' in a group, that is to say, the entity that would be subject to the use of resolution powers under the preferred resolution strategy.

2.6 Internal MREL instruments are issued from legal entities in a group that are not themselves resolution entities. They are issued directly or indirectly to the resolution entity in their group.

2.7 In developing the preferred resolution strategies, the Bank will identify the institution within the group (if any) to which the Bank would expect to apply its resolution powers and which would therefore be the UK resolution entity⁽²⁾ for which external MREL is set.

2.8 The group resolution strategy may either rely upon the use of resolution powers only at the parent of the group — known as a single point of entry (SPE) — or may depend upon

resolution powers being used at more than one entity within the group — known as a multiple point of entry (MPE).

2.9 Under SPE, the internal MREL will be issued by other entities in the group to the resolution entity. In resolution, the write-down and/or conversion to equity of internal MREL will always result in the whole banking group remaining together as a group during the resolution, although parts of it may in time be wound down or sold off.

2.10 Under MPE, some of the resolution entities may issue MREL eligible liabilities either externally or alternatively to another entity higher up in the group. Where an MPE resolution entity has issued MREL eligible liabilities externally, the write-down and/or conversion of the instrument may cause the sub-group that it heads to separate from the rest of the banking group as part of the resolution. This is because the holders of the external MREL resources issued by these resolution entities may become the new shareholders of that entity, leading to a change in control.

3 Framework for setting MREL

3.1 This section sets out the framework the Bank uses to inform the calibration of an institution's MREL. Section 4 describes additional adjustments which may be made on the basis of the preferred resolution strategy for an institution, Section 5 describes additional criteria which liabilities must meet in order to qualify as external MREL resources, Section 6 sets out the Bank's principles for setting MRELS within groups, Section 7 describes internal MREL scope and calibration, Section 8 sets out internal MREL instrument eligibility, and Section 9 sets out the Bank's approach to the transition to final (end-state) MRELS, including interim requirements.

3.2 The Bank will communicate to institutions or their parent companies annually their resolution strategies, the critical functions⁽³⁾ (if any) that they or their group provide, and their external and internal MREL (if any).

3.3 The No. 2 Order and the MREL RTS provide the framework for the calibration of MREL. The Bank will set MREL in accordance with this framework. The MREL RTS uses the pre-existing CRD4⁽⁴⁾ capital requirements (Pillar 1, Pillar 2A and capital buffer requirements) and any applicable leverage ratio as reference points.

(1) PRA (2016), 'The minimum requirement for own funds and eligible liabilities (MREL) — buffers and Threshold Conditions', *PRA Supervisory Statement SS16/16*; available at www.bankofengland.co.uk/prapublications/ss/2016/ss1616.aspx. The PRA has consulted on updating *Supervisory Statement SS16/16* to clarify that the expectations set out in *SS16/16* are not intended to create a different buffer requirement from that which is usable in the going-concern regime, available at www.bankofengland.co.uk/prapublications/cp/2017/cp1517.pdf.

(2) Those institutions within a group in respect of which the use stabilisation powers (other than third country instrument powers) as defined in the Banking Act 2009 is envisaged under the preferred resolution strategy.

(3) See section 3(1) of the Banking Act.

(4) Capital Requirements Directive (2013/36/EU) (CRD) and Capital Requirements Regulation (575/2013) (CRR) — jointly 'CRD4'.

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3.4 The Bank will calculate an institution's baseline MREL as the sum of two components: a loss absorption amount and a recapitalisation amount.

Loss absorption amount

3.5 The Bank will set the loss absorption amount to cover the losses that would need to be absorbed up to and in resolution. The starting point in the MREL RTS is that the loss absorption amount will equal an institution's 'capital requirements'⁽¹⁾ (Pillar 1 plus Pillar 2A or, if higher, the institution's applicable leverage ratio) plus its capital buffers (the combined buffer or, where binding, the PRA buffer).⁽²⁾

3.6 The MREL RTS gives the Bank the discretion to remove capital buffers from the loss absorption amount if they are deemed not to be relevant to absorbing losses in resolution involving stabilisation powers. The Bank must take into account information received from the PRA or FCA, as the competent authority, relating to the institution's business model, funding model and risk profile.

3.7 In light of the PRA policy on the interaction of MREL and capital buffers, in particular that CET1 cannot be used simultaneously to meet both MREL and capital buffers, the Bank expects to exclude buffers from the loss absorption amount for institutions subject to that policy. This includes those institutions with a modified insolvency resolution strategy, including those for which the FCA is the sole competent authority. Therefore the Bank expects generally to set the loss absorption amount equal to an institution's regulatory capital requirements.⁽³⁾

4 Resolution strategies and external MREL

4.1 MREL will be set to ensure that institutions can be resolved in line with the resolution objectives in section 4 of the Banking Act. In particular MREL will be set to enable the preferred resolution strategy for an institution to be effected. This section outlines key factors the Bank will consider when determining the preferred resolution strategy, and how this determination may affect any external MREL that is set for an institution.

4.2 It is important to note that the actual approach taken to resolve an institution will depend on the circumstances at the time of its failure. The preferred resolution strategy may not necessarily be followed if a different approach would better meet the resolution objectives at the time.

Modified insolvency

4.3 The Banking Act provides for a number of modified insolvency regimes for certain institutions (the bank insolvency procedure (BIP), building society insolvency procedure (BSIP) and the special administration regime (SAR)).⁽⁴⁾ Where an institution can enter one of these modified

insolvency regimes at the point of failure, without adversely affecting the achievement of the resolution objectives, the Bank expects to set the recapitalisation component of external MREL at zero. This would mean that an institution's external MREL would be set at a level equal to its capital requirements excluding buffers (Pillar 1 plus Pillar 2A or, if higher, any applicable leverage ratio).

4.4 The Bank will consider a number of factors when determining if it is reasonable to assume that an institution can generally be expected to enter modified insolvency upon failure rather than being resolved using stabilisation powers. Factors indicating that an institution is likely to be able to enter modified insolvency include:

- (a) if the institution's failure is unlikely to cause disruption to the wider UK financial system, either directly through the cessation of services it provides or indirectly by negatively affecting confidence in the financial system or similar institutions;
- (b) if the institution does not provide significant amounts of transactional banking services or other critical functions, particularly those which depend on continuous access to a service which would not be provided in a modified insolvency. The Bank considers that provision of fewer than around 40,000 to 80,000 transactional bank accounts (accounts from which withdrawals have been made nine or more times within a three-month period) is generally likely to indicate that a modified insolvency would be appropriate.

Partial transfer

4.5 In some cases the Bank may determine that, although modified insolvency would not meet the resolution objectives, an institution could feasibly be resolved without use of the bail-in stabilisation power. Where it is feasible for the critical functions of an institution to be transferred to another entity at the point of the institution's failure, the Bank may determine that use of one or more of the Banking Act's transfer powers is the preferred resolution strategy for the institution.

(1) References to 'capital requirements' mean: (i) the amount and quality of own funds the appropriate regulator (PRA or FCA) thinks the institution should maintain at all times under the overall financial adequacy rule (for PRA-authorised persons the Internal Capital Adequacy Assessment 2.1 of the PRA Rulebook and for FCA-authorised persons IFPRU 2.2.1R of the FCA Handbook) as it applies on a solo or a consolidated level; and (ii) (if applicable) the minimum leverage ratio in Leverage Ratio 3.1 of the PRA Rulebook.

(2) Please see the PRA Policy Statement on Pillar 2 for further details: www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1715.aspx.

(3) As set out in the MREL RTS, the loss absorption amount may be adjusted in certain circumstances.

(4) The special administration regime is set out in the Investment Bank Special Administration Regulations 2011 issued by HM Treasury pursuant to section 233 of the Banking Act.

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4.6 Factors indicating that it may be possible to rely on a partial transfer strategy, rather than assuming that bail-in would be used, include:

- (a) if the institution's business and asset/liability structure are sufficiently simple so as to make rapidly separating and transferring critical functions feasible using the Bank's statutory powers;
- (b) if the institution's systems are able to provide the necessary information to support a transfer within the required timeframe;
- (c) if some or all of the institution's business, assets and liabilities (particularly those associated with critical functions) are reasonably likely to be attractive to a private sector purchaser; and
- (d) if the institution is of a size such that the number of potential purchasers is reasonably high.

4.7 The Bank considers that above around £15 billion–£25 billion in balance sheet size a bail-in strategy is more likely to be appropriate, but will make this assessment on an institution-specific basis.

4.8 Where an institution meets the necessary conditions for a partial transfer resolution strategy to be appropriate, its external MREL will be set taking this into account. The Bank expects to consider the following principal adjustments to external MREL for such institutions relative to that set to enable a bail-in strategy for institutions that are D-SIBs:

- (a) Quantum: the recapitalisation component of external MREL might be reduced to reflect the fact that less than the entire balance sheet of the institution will need to be recapitalised at the point of resolution. For example, to the extent that an institution's critical liabilities⁽¹⁾ represent only a proportion of its total liabilities, the recapitalisation component of external MREL may be reduced to reflect this. The Bank will also consider whether any components of Pillar 2A will cease to be relevant as a result of the transfer.
- (b) Subordination: where a partial transfer resolution strategy assumes that only liabilities benefitting from preference in insolvency⁽²⁾ will be transferred, the Bank may not require MREL resources to be subordinated to senior operating liabilities. This is because the transfer can allow all non-transferred liabilities to receive *pari passu* treatment in a bank administration procedure. This reduces the risk of breaches of the 'no creditor worse off than insolvency' (NCWO) safeguard which might occur if the bail-in stabilisation power had been applied but exclusions were made for certain senior liabilities.

Bail-in

4.9 The stabilisation power that is most likely to be appropriate for large complex institutions and groups is bail-in. The Bank is likely to make use of a bail-in strategy for institutions and groups with balance sheets above £25 billion, and will also consider whether bail-in is appropriate for smaller institutions, in particular those with balance sheets greater than around £15 billion. The Bank expects UK resolution entities subject to a bail-in strategy to ensure that their MREL resources are subordinated to operating liabilities, using structural subordination except in the case of building societies which may use contractual subordination or statutory subordination.⁽³⁾ Subordination of MREL resources reduces the risk of breaches of the NCWO safeguard in the event of a bail-in. Further detail is provided in Section 6.

4.10 The Bank currently expects to direct UK resolution entities⁽⁴⁾ in respect of which bail-in is the preferred resolution strategy to comply with an end-state external MREL from 1 January 2022, but subject to review by the end of 2020:

- a. G-SIBs⁽⁵⁾ will be required to meet an external MREL equivalent to the higher of:
 - i. two times the sum of Pillar 1 and Pillar 2A, ie $2 \times (\text{Pillar 1 plus Pillar 2A})$; or
 - ii. the higher of two times the applicable leverage ratio requirement or 6.75% of leverage exposures (in line with the FSB's TLAC standard).⁽⁶⁾
- b. D-SIBs⁽⁷⁾ and any other UK bail-in resolution entities will be required to meet an external MREL equivalent to the higher of:
 - i. two times the sum of Pillar 1 and Pillar 2A, ie $2 \times (\text{Pillar 1 plus Pillar 2A})$; or
 - ii. if subject to a leverage ratio requirement, two times the applicable requirement (ie 6.5% if the leverage ratio is 3.25%).

(1) Those liabilities necessary for the continuity of a critical function.

(2) The BRRD provides for preferential treatment in insolvency of the part of deposits covered by the FSCS or another EEA deposit guarantee scheme, and secondary preference for uncovered eligible deposits of natural persons and small and medium-sized enterprises, as well as deposits that would be eligible deposits of natural persons and small and medium-sized enterprises, were they not made through branches located outside the EU.

(3) Statutory subordination is expected to be possible, following the UK transposition of the EU Bank Creditor Hierarchy Directive (2017/2399).

(4) Those institutions within a group in respect of which the use stabilisation powers (other than third country instrument powers) as defined in the Banking Act is envisaged under the preferred resolution strategy.

(5) Global systemically important banks (G-SIBs) as identified by the Financial Stability Board in consultation with the Basel Committee on Banking Supervision and national authorities.

(6) The Bank does not expect that setting a level below the internationally agreed minimum for G-SIBs would be sufficient to ensure market confidence.

(7) Domestic systemically important banks (D-SIBs) are those institutions that are subject to the PRA leverage ratio requirement (ie with retail deposits over £50 billion) and/or any institutions that are designated as an O-SII (other systemically important institution) by the PRA pursuant to article 131(3) of the Capital Requirements Directive (2013/36/EU), and which have a resolution entity in the United Kingdom.

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5 External MREL instrument eligibility

5.1 In order for MREL resources to fulfil their intended purpose, it must be practically straightforward for the Bank to apply its stabilisation powers to them, including the bail-in stabilisation power.

5.2 The No. 2 Order sets out a number of requirements that liabilities must meet in order to qualify as MREL eligible liabilities.⁽¹⁾ One of these is that the liability must have an effective remaining maturity (taking account of any rights for early repayment available to the investor) of greater than one year.

5.3 In addition, the Bank expects institutions to consider the overall maturity profile of their externally issued MREL eligible liabilities, and to ensure that temporary difficulties in accessing debt capital markets would not be likely to cause a breach of their MREL. The average maturity of institutions' MREL eligible liabilities may decrease in periods of market stress, and the Bank does not intend to apply a minimum maturity requirement to eligible liabilities beyond that applicable under the No. 2 Order. The Bank may use its powers of direction to further specify eligibility criteria for MREL eligible liabilities for individual institutions.

5.4 The No. 2 Order states that where a liability confers a right to early reimbursement upon its owner the maturity date of the liability shall, for the purposes of determining whether it is an MREL eligible liability be considered to be the first date at which such a right arises. The Bank expects institutions not to structure their MREL eligible liabilities in such a way as to reduce their effective maturity, for example liabilities which create incentives for the issuer to redeem them ahead of the contractual maturity date. An increase in the interest rate payable on a liability (a 'step up') coinciding with an issuer call option is an example of an incentive to redeem in this context. Where liabilities do include such an incentive, the maturity date of the liability shall, for the purposes of determining whether it is an MREL eligible liability, be considered to be the date at which the incentive arises.

5.5 An institution should not call or redeem an MREL eligible liability if that would cause it to breach its MREL, or if the institution is already in breach of its MREL, unless the Bank approves such a transaction.

5.6 The Bank does not consider liabilities, the value of which is dependent on derivatives, to be appropriate to qualify as MREL eligible liabilities. The Bank does not consider liabilities which only include put or call options to be dependent on derivatives for this purpose.

5.7 Liabilities subject to contractual set-off or netting arrangements are not appropriate MREL eligible liabilities.

5.8 Where a liability is governed by non-EEA law, institutions will need to ensure that the liability could absorb losses and contribute to recapitalisation costs in resolution, having regard to the terms of the contract and legal opinions, in line with the BRRD and the contractual recognition of bail-in rules in the PRA Rulebook and FCA Handbook.⁽²⁾

5.9 MREL eligible liabilities should be issued externally from the resolution entity, subject to the provision in paragraph 6.6 permitting internal issuance for MPE resolution entities.

5.10 The Bank's view is that institutions 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,⁽³⁾ 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 institutions' resolvability.

5.11 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. The FSB's TLAC standard provides that such externally issued non-CET1 own funds instruments should not count towards TLAC from 1 January 2022. Institutions 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 institutions' 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.

5.12 The responsibility for ensuring that liabilities, including own funds instruments, are eligible as MREL rests with institutions. Institutions should obtain independent legal advice on a liability's eligibility, and provide this to the Bank where required.

(1) See in particular article 123(4).

(2) See www.prarulebook.co.uk/rulebook/Content/Part/211722/26-10-2016 and www.handbook.fca.org.uk/handbook/IFPRU/11/6.html?date=2016-06-30.

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

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5.13 In line with the continuous resolvability assessment process, institutions will also be expected to demonstrate compliance with the eligibility criteria on request.

6 MREL in the context of groups

6.1 The Bank will set an external MREL at the group consolidated level. In addition, the Bank will set individual MRELS for all institutions within the group. The Bank may also set individual MRELS for relevant persons that are important from a resolution perspective (for example holding companies) on an entity-specific basis. The individual MRELS may be determined on the basis of consolidated or sub-consolidated balance sheets, in addition to an entity's own balance sheet (see paragraphs 7.4–7.5 below).

6.2 The Bank will require groups or institutions in respect of which bail-in is the preferred resolution strategy to structure their liabilities to achieve structural subordination of external MREL resources issued by resolution entities. MREL resources which are structurally subordinated may also be contractually or statutorily⁽¹⁾ subordinated. Mutually owned institutions such as building societies may not be able to operate with holding companies without changes to their form of incorporation, limiting their ability to achieve structural subordination of MREL resources. In such cases the Bank expects institutions with a bail-in strategy to issue contractually or statutorily subordinated liabilities to satisfy their MRELS.

6.3 For institutions subject to structural subordination, MREL resources issued externally by resolution entities should not rank *pari passu* with significant amounts of other liabilities that do not meet the MREL eligibility criteria set out in the No. 2 Order. Accordingly, the sum of a resolution entity's liabilities that do not qualify as MREL (excluding liabilities that previously met the MREL eligibility criteria but no longer meet the minimum maturity requirement as referred to in paragraph 5.2 above) should not exceed 5% of the resolution entity's overall external MREL resources. In addition, 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.

Availability of surplus MREL in groups

6.4 Resolution entities will be required to issue external MREL resources at least equal to all the internal MREL resources that are issued to them from their subsidiaries or, in other jurisdictions, equivalent subordinated instruments that can absorb losses and recapitalise a subsidiary, such as through being written down and/or converted to equity, without the use of stabilisation or resolution powers at the subsidiary level ('internal loss-absorbing resources'). For groups with UK resolution entities, the Bank expects that any '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. 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), and may review its approach as part of assessing institutions' resolvability.

External MREL for MPE resolution entities

6.5 For groups with an MPE strategy, the Bank expects that each resolution entity will be set an external MREL or an equivalent requirement if applicable in non-EU jurisdictions. The Bank will set MREL for any UK resolution entity, based on the balance sheet of the local resolution group, in line with the calibration framework set out in this Statement of Policy. As this is external MREL, there will be no scaling of the requirement applicable at a resolution entity even if it issues MREL instruments to another member of its group. This is because each resolution group needs to have sufficient MREL to be self-sufficient in resolution.

6.6 The Bank proposes to permit the resolution entities of UK-headquartered groups with an MPE resolution strategy to issue MREL eligible liabilities either to investors outside the group or, alternatively, to another entity higher up in the group provided the Bank is given sufficient assurance that any issuance strategy proposed by an MPE group supports a feasible and credible resolution plan. Where MREL of a resolution entity is issued internally, the Bank will require this internally issued MREL to meet the same eligibility criteria as internal MREL of a material subsidiary.

6.7 A UK resolution entity should not double count MREL resources. In order to achieve this, the Bank expects that the external MREL for a UK MPE resolution entity will be increased by the amount of any MREL or equivalent investments its resolution group has made in its other resolution groups or entities or sub-groups located outside these resolution groups, where the investments are not covered by arrangements that ensure this outcome (such as a capital deductions regime for investments in own funds instruments in subsidiaries).

Group consolidated MREL for MPE groups

6.8 Where it is the home authority for the ultimate parent company of an MPE banking group, the Bank expects to set a consolidated external MREL that the group as a whole must meet, in addition to any requirement that it imposes on the UK resolution entity in respect of its resolution group (which would be calibrated in accordance with Section 4). This is consistent with the FSB's TLAC standard for G-SIBs. It reduces

(1) Statutory subordination is expected to be possible, following the UK transposition of the EU Bank Creditor Hierarchy Directive (2017/2399).

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the risk that there will be insufficient MREL if losses arise in parts of the group that have no or low levels of MREL resources.

6.9 Accordingly, where the Bank is the home authority for the ultimate parent of a G-SIB, the Bank proposes that the group consolidated MREL that would apply to the parent between 2019 and 2022 should reflect the FSB's TLAC standard and therefore constitute the highest of: (i) 16% of RWAs; (ii) 6% of leverage exposures on a consolidated basis; and (iii) the sum of requirements relating to each of its resolution groups and entities or sub-groups located outside these resolution groups. The 'sum of requirements' is the sum of the binding MREL (or equivalent requirement) or capital requirement for each of the resolution groups or other entities or sub-groups outside these resolution groups. From 1 January 2022 it should reflect the highest of: (i) 18% of RWAs; (ii) 6.75% of leverage exposures on a consolidated basis; and (iii) the sum of requirements relating to each of its resolution groups and other entities or sub-groups located outside these resolution groups.

7 Internal MREL

Scope

7.1 Internal MREL above capital requirements is likely to be necessary only where the Bank considers that the insolvency of the institution would put the Bank's resolution objectives at risk.⁽¹⁾ The Bank expects to set internal MREL above capital requirements for a 'material subsidiary' of a group where either (a) there is a UK resolution entity in the same group which is or will become subject to an external MREL above its capital requirements or (b) in the case of UK subsidiaries of overseas groups, the subsidiary delivers critical functions in the United Kingdom.⁽²⁾

7.2 The Bank expects to set internal MREL equal to capital requirements (where applicable) for institutions that are not material but for which the Bank is required to set MREL.

7.3 An institution is a 'material subsidiary' if it is incorporated in the United Kingdom, is not a UK resolution entity, and it meets at least one of the following criteria:

- a. has more than 5% of the consolidated risk-weighted assets of the group; or
- b. generates more than 5% of the total operating income of the group; or
- c. has a total leverage exposure measure larger than 5% of the group's consolidated leverage exposure measure; or
- d. exceptionally, is otherwise 'material', either directly or through its subsidiaries, to the delivery of a group's critical functions. The Bank will continue to review groups'

structures and critical functions to judge if this criterion applies to any entities.

7.4 Internal MREL will apply to the parent institution in an existing prudential consolidation or sub-consolidation — where the consolidated or sub-consolidated regulatory group meets the criteria in paragraphs 7.1–7.3 — which will be calculated with reference to its consolidated or sub-consolidated prudential requirements. The consolidation or sub-consolidation which is used to calculate internal MREL in such cases is referred to as a 'material sub-group'. A material subsidiary that heads up such a sub-group will be bound by the higher of its internal MREL calculated on an individual or consolidated/sub-consolidated balance sheet basis.

7.5 Where no prudential sub-consolidation currently exists for a material subsidiary, the Bank reserves the right to require the institution to draw up a sub-consolidated balance sheet to enable the Bank to calculate internal MREL for that material subsidiary on a consolidated or sub-consolidated basis. Such circumstances might arise 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. This is independent from any decision by the PRA or FCA on whether to set prudential requirements for the material subsidiary on a consolidated or sub-consolidated basis.

Calibration

7.6 The intra-group distribution of internal MREL resources must ensure that sufficient loss-absorbing capacity is pre-positioned within the group to ensure that losses can be absorbed and passed up to the resolution entity or entities from material subsidiaries.

7.7 The Bank expects that internal MREL for a material subsidiary will be scaled in the range of 75% to 90% of the full amount of external MREL that it would otherwise be required to maintain if the material subsidiary were itself a UK resolution entity and its external MREL were set in accordance with Section 4. In deciding whether to set internal MREL for a material sub-group or subsidiary above 75% scaling, the Bank will take into account the following considerations:

- The resolution strategy applicable to the group and the credibility of the resolution plan for delivering it.
- The availability of other uncommitted resources within the group that could be readily deployed to support the material subsidiary.

(1) For example, paragraph 4.4 provides an indicative threshold that institutions with below 40,000–80,000 transactional accounts would have a modified insolvency resolution strategy.

(2) See section 3(1) of the Banking Act.

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- The scaling of internal loss-absorbing resources applied by overseas authorities to material subsidiaries located in their jurisdiction.

7.8 These factors allow the Bank to set internal MREL based on discussion with other authorities in CMGs — as envisaged in the FSB's TLAC standard, resolution colleges — as required by the BRRD, or other forums.

7.9 The largest banking groups in the United Kingdom are subject to legislation⁽¹⁾ which will require them to carry out their core UK financial services and activities within a ring-fenced body (RFB) and separate these from certain other activities of the wider group. Where an RFB is part of a material sub-group (see paragraph 7.4), the Bank expects to scale the internal MREL for the top entity of the material sub-group at 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.⁽²⁾ This approach is intended to ensure that the setting of internal MREL for RFBs is in line with the range set out in the FSB's TLAC standard while minimising the RFB's dependence on the rest of the group, consistent with the PRA's ring-fencing objectives. 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 future.

7.10 Within an RFB's material sub-group, the Bank intends to set internal MREL for individual RFBs in line with the approach for setting internal MREL for other types of material subsidiary.

7.11 For UK groups with a simple structure — for example, a single material subsidiary that sits below a UK resolution entity with few, if any other, subsidiaries — the Bank would not expect to adjust downwards the internal MREL for that UK material subsidiary. This means the internal MREL would be set at 100% of the external MREL that would have applied to the material subsidiary if it were a resolution entity. The Bank would also apply this approach for the top entity of material sub-groups containing an RFB or for an RFB which is not part of a material sub-group if the RFB's group has a simple structure. 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. The Bank 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 groups, so as to ensure that a resolution group has sufficient MREL to be self-sufficient in resolution.

7.12 In the case of an institution that is a material subsidiary of a banking group that is not headquartered in the

United Kingdom, the Bank will set the amount of internal MREL following discussion with the home authority in CMGs, resolution colleges or other forums.

7.13 The Bank expects to propose a quantum for internal MREL for non-UK material subsidiaries — where the host authority has not published regulations or regulatory proposals. In doing so, the Bank expects to be guided by the principles set out in this Statement of Policy.

7.14 A subsidiary or sub-group should only count the internal MREL resources that it issues towards meeting its own internal MREL. Where an institution has subsidiaries that also have internal MREL or equivalent resources, it should ensure that it has sufficient internal MREL resources to match both its own individual MREL as well as the internal MREL or equivalent resources of its subsidiaries. In order to achieve this, 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, where the investments are not covered by arrangements that ensure this outcome (such as a capital deductions regime for investments in own funds instruments in subsidiaries).

8 Internal MREL instrument eligibility

8.1 All the eligibility criteria set out in paragraphs 5.2–5.8 that apply to external MREL eligible liabilities apply equally to internal MREL eligible liabilities. The considerations in paragraph 5.10 apply to non-CET1 own funds instruments in respect of internal MREL.

8.2 In addition to these eligibility criteria, internal MREL eligible liabilities will be subject to some additional eligibility criteria in order to achieve their purpose. In summary, these are eligibility criteria relating to:

- (1) subordination;
- (2) the holder of the instrument;
- (3) contractual triggers; and
- (4) mismatching of internal and external MREL.

Subordination

8.3 As in the case of eligibility for external MREL liabilities, internal MREL resources must be subordinated to the operating liabilities of the group entities issuing them. This is necessary to ensure that, in converting internal MREL, the Bank is not required to bail-in liabilities that might otherwise rank *pari passu* and which may either be difficult to bail-in or would result in a change of ownership of the entity if

(1) The Financial Services and Markets Act 2000, as amended by the Financial Services (Banking Reform) Act 2013.

(2) This may not apply in certain cases, including: (1) where the top entity within an RFB's material sub-group is a resolution entity, it will be subject to external MREL and so scaling will not apply to it; and (2) where the RFB's group has a simple structure, the Bank would not expect to adjust downwards the internal MREL (see paragraph 7.11).

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converted into equity. Internal MREL eligible liabilities will need to be contractually or statutorily⁽¹⁾ subordinated. However, if the entity is a holding company, it may be permitted to issue internal MREL instruments as senior liabilities provided that the sum of its liabilities that do not meet the other internal MREL eligibility criteria (excluding liabilities that previously met the internal MREL eligibility criteria but no longer meet the minimum maturity requirement referred to in paragraph 5.2 above) do not exceed 5% of the entity's overall internal MREL resources (see Section 6). In addition, the sum of those liabilities that do not qualify as internal MREL in each creditor class should not exceed 10% of the entity's internal MREL resources in that same creditor class.

The holder of the instrument

8.4 Institutions and groups should ensure that the issuance of internal MREL by a material subsidiary or sub-group credibly supports the resolution strategy and the passing of losses and recapitalisation needs to the resolution entity. Internal MREL eligible liabilities must be issued either directly or indirectly via other entities in the same resolution group to the parent resolution entity. The Bank 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; for example, there are circumstances in which writing down or converting internal MREL could result in a change of control or if there were significant governance or tax issues as a result.

8.5 As part of resolution planning, the Bank will consider the extent to which subsidiaries' non-CET1 MREL resources are issued to group entities other than their direct parent in relation to their potential effects on a group resolution as well as on post-resolution restructuring options. The Bank will discuss the distribution of MREL resources generally with institutions as part of the process of setting MREL.

8.6 Internal MREL eligible liabilities should be issued internally from non-resolution entity subsidiaries. Where own funds instruments issued externally by a non-resolution entity subsidiary count towards that subsidiary's individual capital requirement, under the 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. Institutions 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 institutions' 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

8.7 Internal MREL eligible liabilities must be capable of being written down and/or converted to equity without or ahead of any use of stabilisation powers in relation to the entity which issues them.

8.8 As a general matter, the trigger for an internal MREL eligible liability will need to provide the Bank as resolution authority of the material subsidiary with the opportunity to direct an immediate write-down 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:

- (a) any own funds instruments of the material subsidiary 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 institution; 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
- (b) a resolution entity in the material subsidiary's group, which is a direct or indirect parent of the material subsidiary, is subject to resolution proceedings in the United Kingdom or elsewhere.⁽²⁾

8.9 The contractual trigger should provide the resolution authority of the material subsidiary with the opportunity to direct either a write-down or a conversion (as directed by the resolution authority) in the circumstances specified in paragraph 8.8 above. However, the contractual trigger may be limited to provide for only write-down or only conversion if institutions 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. Institutions 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 result. The Bank may consider any challenges to resolvability presented by the

(1) Statutory subordination is expected to be possible, following the UK transposition of the EU Bank Creditor Hierarchy Directive (2017/2399).

(2) 'Resolution proceedings' mean the exercise of a resolution tool by a 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.

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specification of contractual triggers as part of assessing institutions' resolvability.

8.10 With respect to non-CET1 own funds instruments, institutions should consider whether the absence of such contractual triggers, covering the circumstances described in (b) in paragraph 8.8 above could create difficulties for resolution. Such contractual triggers support the ability to co-ordinate the write-down and/or conversion of internal MREL instruments 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)⁽¹⁾ where it is not possible to write down and/or convert the non-CET1 own funds instruments to CET1 using statutory powers, 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 any challenges to resolvability presented by such instruments as part of assessing institutions' resolvability.

8.11 In the Bank's opinion there is likely to be significant merit in including the contractual trigger features in a single 'umbrella' agreement. 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 trigger.

8.12 The particular features of the contractual terms of an institution's internal MREL may depend on the group's or institution's resolution strategy and may require discussion between the group and the Bank. Having confirmed these features, the responsibility for ensuring that instruments, including own funds instruments, are eligible as MREL rests with the institution. Institutions should obtain independent legal advice on a liability's eligibility, and provide this to the Bank where required. Institutions are expected to notify the Bank where they do not intend to include the additional contractual provisions in own funds instruments. In line with the continuous resolvability assessment process, institutions will also be expected to demonstrate compliance with the eligibility criteria on request.

Mismatching of internal and external MREL

8.13 The Bank will periodically review the extent to which internal MREL resources of a material subsidiary differ in form — such as equity or debt, currency, maturity, interest rate, and other terms and covenants — from the MREL issued externally from the resolution entity where this may pose risks to the resilience and resolvability of the group. Institutions should notify the Bank if they expect there to be any material change in the form of their internal MREL resources. Institutions

should not change the form of their internal MREL resources in any way, such as through cancellation or conversion to equity, that reduces the amount of MREL eligible liabilities, unless the Bank approves such a transaction.

8.14 Where the Bank identifies instruments, including those that are *pari passu* with internal MREL resources, or features or mismatches, that constitute an impediment to successful resolution, the Bank may consider using its powers under section 3A of the Banking Act to direct relevant persons to address impediments to resolvability. The Bank will consult with the competent authority on any actions that the Bank proposes to take under section 3A.

9 Transitional arrangements

General transitional arrangements

9.1 The MREL RTS allows the Bank to determine an appropriate transitional period for an institution to reach its end-state MREL. The transition period must be as short as possible.

9.2 To allow institutions flexibility over timing of changes to their capital structures in order to meet MREL, generally the Bank does not expect to direct institutions to maintain MREL greater than its regulatory capital requirements prior to the dates set out in paragraph 9.4 below. The Bank has however provided UK resolution entities (on a bilateral basis) with an indication of the external MREL that is likely to apply at the consolidated level at the end of the relevant transitional period (in the first instance the interim MREs). The Bank also proposes to provide institutions with an indication of the internal MREL that is likely to apply at the end of the relevant transitional period. The Bank expects institutions to produce a plan for how they intend to meet their MREs, and to discuss this plan with the Bank and the relevant competent authority (the PRA or the FCA) at the earliest possible opportunity.

9.3 The Bank currently expects to direct institutions to comply with an end-state external MREL (calculated in accordance with the methodology described in Sections 3 and 4 above) and internal MREL (calculated in accordance with the methodology described in Section 7 above) from 1 January 2022. The clean holding company requirements described in paragraph 6.3 will also apply from 1 January 2022. Before that date, relevant persons 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).

9.4 Notwithstanding paragraph 9.3 above, to ensure that institutions make progress towards meeting their end-state

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

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requirements the Bank expects to direct institutions to meet the following interim MREs and internal MREs:

- (a) From 1 January 2019 UK resolution entities that are G-SIBs will be required to meet the minimum requirements set out in the FSB TLAC standard, being the higher of 16% of RWAs or 6% of leverage exposures.⁽¹⁾ At the same time, material subsidiaries of G-SIBs that are incorporated in the United Kingdom will need to meet these minimum requirements multiplied by an institution-specific scalar that is determined by the Bank.⁽²⁾
- (b) From 1 January 2020:
- a. UK resolution entities that are G-SIBs or D-SIBs will be required to maintain MREL equal to the higher of:
 - i. two times their Pillar 1 capital requirements and one times their Pillar 2A add-ons, ie (2 x Pillar 1) plus (1 x Pillar 2A); or
 - ii. if subject to a leverage ratio requirement, two times the applicable requirement (ie 6.5% if the leverage ratio requirement is 3.25%). G-SIBs in any case must meet a requirement of at least 6% of leverage exposures.

At the same time, material subsidiaries of G-SIBs or D-SIBs that are incorporated in the United Kingdom will need to meet these minimum requirements multiplied by an institution-specific scalar that is determined by the Bank.

- b. UK resolution entities which are not G-SIBs or D-SIBs, will be required to maintain MREL equal to 18% of RWAs. At the same time, material subsidiaries of these institutions that are incorporated in the United Kingdom will need to meet this minimum requirement multiplied by an institution-specific scalar that is determined by the Bank.

9.5 The Bank will, before the end of 2020, review the calibration of MREL, and the final compliance date, prior to setting end-state MREs. In doing so, the Bank will have particular regard to any intervening changes in the UK regulatory framework as well as institutions' experience in issuing liabilities to meet their interim MREs.

9.6 As set out in the PRA's supervisory statement on the interaction of MREL and the capital framework, the PRA's policies on the interaction of MREL and capital buffers and Threshold Conditions will apply with respect to both interim and end-state MREs. Please consult Chapter 4 of the PRA supervisory statement for further details.

Institution-specific transitional arrangements

9.7 The Bank may on an institution-specific basis set an earlier compliance date during the transition period for interim (external and internal) MREs and/or end-state MREs greater than capital requirements, for example where the Bank has concerns about the resolvability of a group or institution, or to implement international standards.

9.8 The MREL RTS allows the MREL applicable to an institution to be reduced where that institution has entered resolution and been subject to stabilisation powers. This allows MREL resources to be 'used' in resolution and for the institution (or its successor entities) to rebuild these resources over time. The Bank expects to reduce the external and/or internal MREL applicable to an institution which has been resolved as necessary, such that the institution would not be in breach of MREL immediately following resolution.

9.9 The Bank may also set 'transitional' MREL, including after the end of the initial transitional period, if the necessary MREL for an institution changes. This might occur, for example, if the resolution strategy applicable to the institution changes, or if the regulatory requirements for the institution change in a way that affects its MREL. The Bank will determine the appropriate transitional period on an institution-specific basis, and expects to allow at least 36 months for transition for external MREL where the change in MREL is material. The Bank would expect to determine similar transitional arrangements for a group's internal MREL as for its external MREL. However, where groups are already subject to external MREL in excess of capital requirements, the Bank will determine the appropriate transitional period to meet internal MREL on an institution-specific basis for any subsidiaries that are newly designated as material.

(1) Leverage exposure shall be calculated on the same basis as the PRA's leverage ratio requirement.

(2) '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.