BANK OF ENGLAND

The FSB’s TLAC standard and the EU’s MREL provisions: UK implementation

Presentation to CCBS Workshop for heads of financial stability, 22-23 February, 2016

Peter Brierley, Resolution Directorate, Bank of England

The FSB’s TLAC standard

- In November 2015, the Financial Stability Board (FSB) published its final ‘**Total Loss Absorbing Capacity’ (TLAC) standard for G-SIBs.**
- Supported by impact studies:
  - Manageable **shortfalls**: greater need for restructuring of existing debt than net issuance of new debt
  - Limited impact on **markets**
  - Large **benefits** (reduction in likelihood and costs of crises) relative to **costs** (increase in funding costs, effect on lending/real economy)
  - Historical **losses** and recapitalisations support TLAC of at least 16-20% RWAs

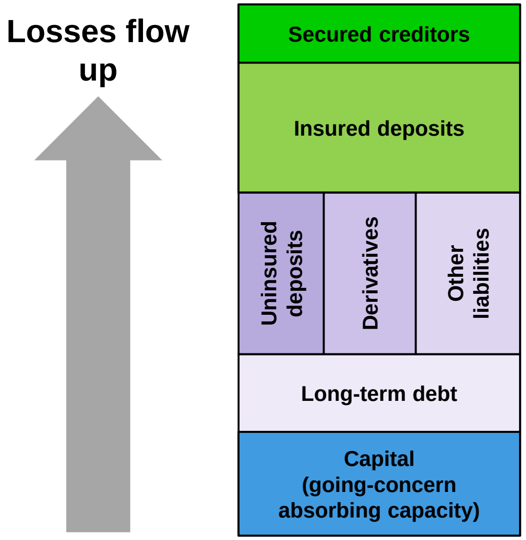
BANK OF ENGLAND

What is TLAC?

- TLAC is a **minimum requirement on the liabilities side** of G-SIB balance sheets.
- It can be met with **capital** or other **unsecured long-term liabilities**
- **Absorbs losses** and **recapitalises** failed firms (or successors) in resolution
- Helps ensure **continuity of critical functions** and an orderly wind-down / restructuring.
- It is a **firm-specific** minimum requirement – with a **common minimum level**.
- TLAC is not a legally binding requirement. **It is a political commitment.**
- **TLAC will be implemented in the UK/EU through MREL**. Other countries (e.g. US and Switzerland) have already published proposals.

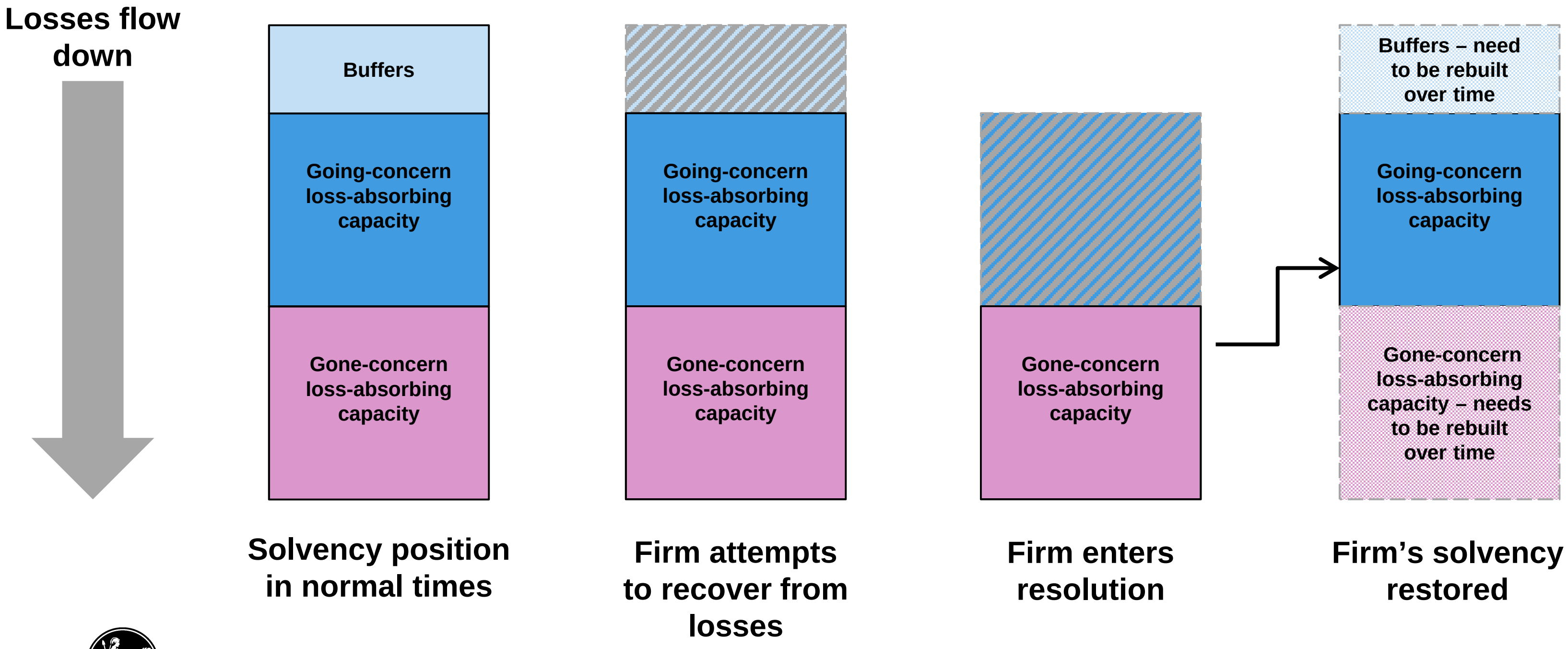
BANK OF ENGLAND

Order of loss absorbency in resolution



- TLAC = capital + long term (subordinated) debt
- TLAC should absorb losses before operating liabilities eg deposits and derivatives
- Order of loss absorbency in insolvency should generally be followed in resolution.

Using TLAC in resolution

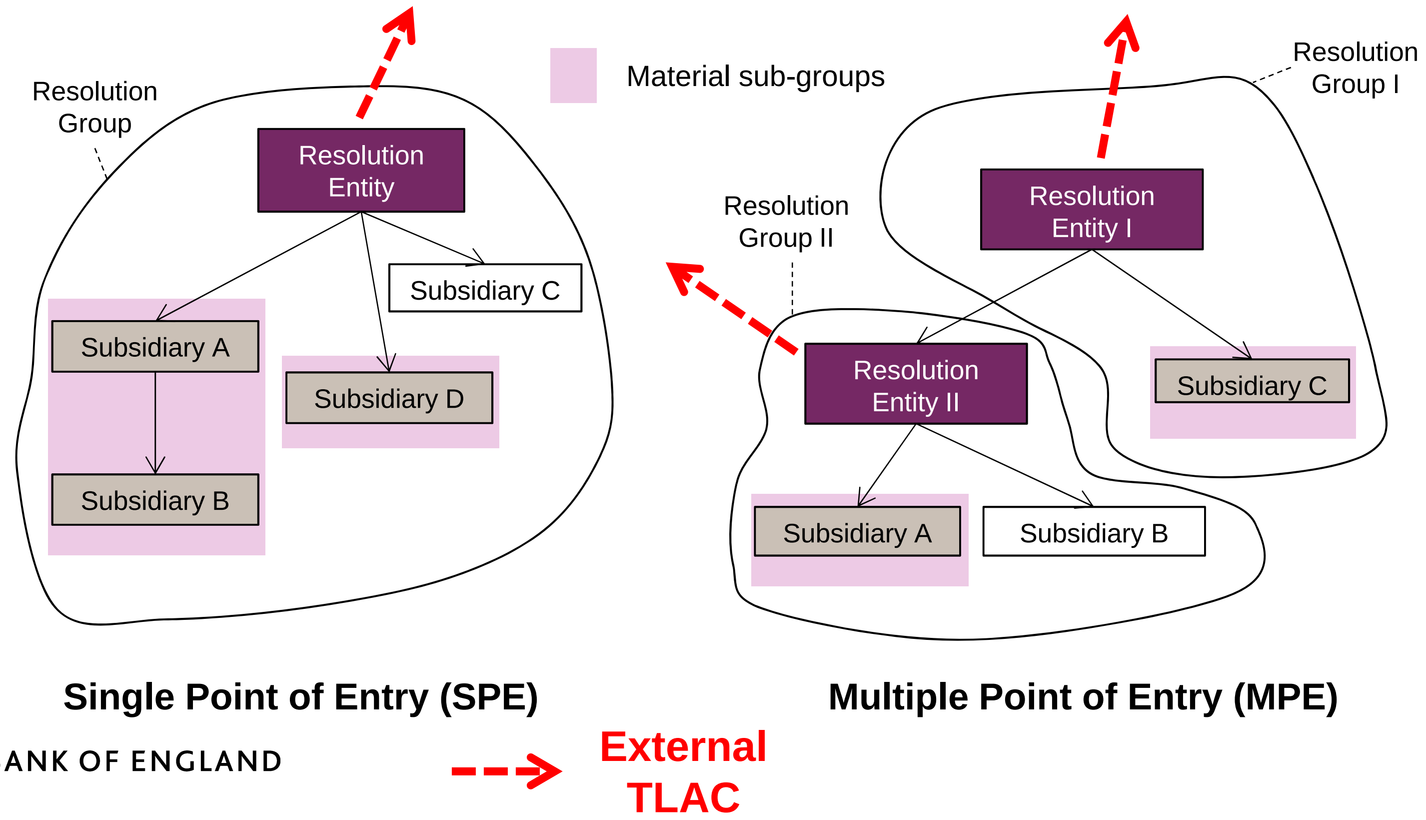


BANK OF ENGLAND

Resolution and group structures

- **External TLAC** requirements apply to **resolution entities**. Resolution entities may be bank holding or operating companies.
- **Only the resolution entity enters resolution**.
- In **Single Point of Entry (SPE)** resolution strategies there is one resolution entity. In **Multiple Point of Entry (MPE)** resolution strategies there is more than one resolution entity.
- **Internal TLAC** requirements apply to **material sub-groups (**or individual subsidiaries) within the group. Internal TLAC is necessary to make sure that losses flow from operating subsidiaries to resolution entities.

Which entities will need external TLAC?



BANK OF ENGLAND

TLAC requirement – Qualifying Instruments

- Virtually **all regulatory capital instruments**, but …
- … no double counting of CET1 to TLAC and buffers!
- Debt that can **readily be written-down/converted into** equity in resolution (bailed-in). Must:
  - Be **unsecured**
  - Have a minimum residual **maturity of > 1 year**
  - **Arise through a contract** (e.g. no tax liabilities)
  - … and be **subordinated** to liabilities that are explicitly excluded from TLAC.

BANK OF ENGLAND

Subordination to liabilities excluded from TLAC

- Some liabilities are **explicitly excluded** from TLAC:
  - Insured, sight and short-term deposits
  - Preferred liabilities (eg in EU uninsured deposits of persons/SMEs)
  - Fully secured debt
  - Derivatives and structured notes
  - Liabilities that are excluded from bail-in or that cannot be bailed in without material legal risk or that are non-contractual (eg tax liabilities)
- **Subordination to "excluded liabilities"**
  - Avoids risk of successful legal challenge by reducing likelihood of need to depart from pari passu if losses extend to senior unsecured debt
  - Ensures clarity in order of loss absorbency

BANK OF ENGLAND

Calibration of TLAC

- Authorities must set TLAC appropriate for firm, subject to a common minimum floor of:
  - From **1 January 2019**: higher of **16%** of consolidated RWAs and **6%** of Basel 3 leverage ratio denominator.
  - From **1 January 2022**: higher of **18%** of consolidated RWAs and **6.75%** of Basel 3 leverage ratio denominator.
- **Delay of six years for China** (but may be brought forward by review)
- Subject to strict conditionality, allowances of **2.5% / 3.5% RWA** for senior debt (eg in the EU) and resolution or deposit insurance funds (Japan, not available in the EU or US).

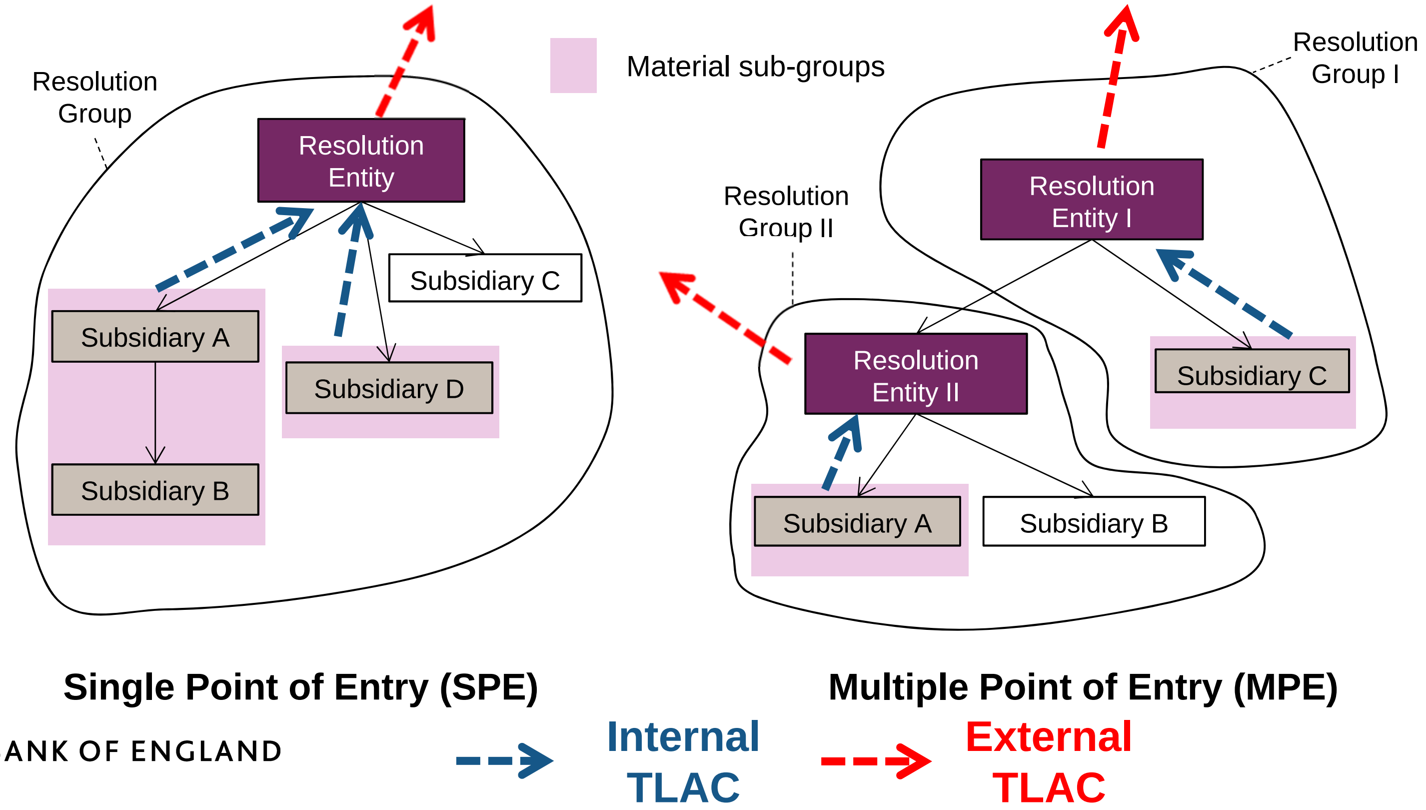
BANK OF ENGLAND

Intragroup Arrangements: Internal TLAC

- **Material sub-groups** must meet internal TLAC requirements
- Internal TLAC must generally be **issued to the resolution entity**
- Can be met through **capital instruments or subordinated convertible debt**
  - No resolution tools should be needed to write down/convert ITLAC
  - **Operating subsidiaries stay out of resolution**
- It is the means by which losses flow to the resolution entity
- Internal TLAC must generally be **75 – 90% of external TLAC**
- Internal TLAC should be funded by External TLAC – **no "double leveraging"** please!

BANK OF ENGLAND

Which entities will need internal TLAC?



BANK OF ENGLAND

Disclosure and holdings of TLAC

- G-SIBs must disclose the amount, maturity, and composition of external and internal TLAC at **legal entity** level
- **BCBS to consult shortly** on proposed disclosure requirements and finalise disclosure standard by end-2016
- G-SIBs’ exposures to other G-SIBs’ TLAC **must be deducted from their own TLAC or regulatory capital**
- BCBS consultation paper of 9 November 2015 proposed that all banks’ exposures to G-SIBs’ TLAC be **deducted from their own regulatory capital**, starting with Tier 2, subject to a threshold

MREL (Minimum Requirement for own funds and Eligible Liabilities)

- Under the EU Bank Recovery & Resolution Directive (**BRRD**) the Bank (as UK resolution authority) must set MREL for **all** banks, building societies and 730k investment firms, in consultation with PRA (or FCA) from 1 Jan 2016.
- **No minimum level** – BRRD sets out criteria which must be considered when setting firm-specific MREL.
- **Broad** instrument eligibility criteria, with scope for authorities to narrow.
- Requires **joint decisions** on MREL for pan-EU firms in resolution colleges.
- Bank published **consultation paper** on its proposed approach to setting MREL on 11 December 2015, accompanied by a PRA CP on the interaction of MREL and capital requirements. **Policy statements** to follow in mid-2016.

MREL and TLAC

MREL	TLAC
EU legal requirement	G20 level political agreement
Applies to all banks, building societies and 730k investment firms	Applies to G-SIBs
No 'hard' number in legislation – criteria further specified in EBA RTS	16% and then 18% of RWAs plus 'Pillar 2' amounts
Includes capital & term debt (>1 year)	Includes capital & term debt (>1 year)
Flexibility to require subordination	Mandatory subordination
Legislation silent on CET1 buffers	CET1 buffers must sit 'on top' of TLAC

BANK OF ENGLAND

MREL can be set so as to be compatible with TLAC: they are equivalent concepts

MREL and resolution strategies

- MREL must be set on a **firm-by-firm** basis, depending on preferred resolution strategy.
- We distinguish between 3 broad resolution strategies: (1) **bail-in**; (2) **partial transfer** to a third party buyer or bridge bank; (3) modified **insolvency**
- We expect to use a number of **indicative thresholds** to guide the setting of resolution strategies, and thus MREL:
  - Bail-in vs transfer: for balance sheet sizes above **£25bn** we assume a partial transfer is unlikely to be feasible, and would expect to use bail-in. This would be considered for firms down to **£15bn**.
  - Transfer vs insolvency: the only critical function provided by smaller retail firms is transactional bank accounts. We expect to use thresholds of **40,000** accounts to indicate when insolvency may no longer be appropriate.

Calibration of MREL

- MREL set as the **sum** of amounts needed to **absorb losses** up to and in resolution, and of **recapitalisation** needed post-resolution (EBA RTS).
- **Loss absorption** amount assumes regulatory capital requirements (P1+P2A), including CET1 buffers, are **fully eroded** by losses before and in resolution.
- **Recapitalisation** amount depends on capital required to support proportion of balance sheet which remains following preferred **resolution strategy:**
  - **Bail-in:** whole balance sheet, so total current minimum capital requirement
  - **Partial transfer:** proportion of balance sheet transferred, so scaled down minimum capital requirement
  - **Modified insolvency:** no recapitalisation needed so zero capital requirement

Resolution strategy	MREL quantum*		MREL quality
	Loss absorption	*Recapitalisation*	
Bail-in	Pillar 1 · Pillar 2A	Pillar 1 · Pillar 2A	Subordination required (with presumption of structural subordination)
Partial transfer	Pillar 1 · Pillar 2A	Pillar 1 · P 2A	No subordination required
Modified insolvency	Pillar 1 · Pillar 2A	N/A	N/A

* For simplicity only MREL based on RWAs is shown. MREL based on any applicable leverage ratio or the Basel I floor may be relevant for certain institutions.

UK implementation

- Bank as UK resolution authority will **implement TLAC via MREL**
- Implementation by **1/1/20** (1/1/19 initially for UK G-SIBs); generally no additional requirements during **transitional period**
- **Indicative target MRELs** for UK G-SIBs & other large firms later in 2016 and annually thereafter
  - Internal MRELs to follow in 2017/18
  - May be another CP late 2016: internal MREL, reporting, disclosure ...
- For UK G-SIBs & large firms: baseline is **MREL = 2 x (P1 + P2A)**.
- For **UK subs of foreign G-SIBs**: set MRELs in co-ordination with home authority during 2016 / early 2017

BANK OF ENGLAND

Ongoing MREL issues…

- Intra-group MREL
- Pillar 2A adjustments
- Instrument eligibility
- Reporting
- Disclosure
- Deductions
- Interaction with large exposures
- EBA review / Commission legislation

BANK OF ENGLAND