BANK OF ENGLAND

News release

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Consultation Paper: The Bank's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

As announced in the "Framework of capital requirements for UK banks" published on 1 December 2015, the Bank of England is today launching a consultation on its approach to setting a minimum requirement for own funds and eligible liabilities (MREL) for all UK banks, building societies and certain investment firms.

The purpose of MREL is to require these firms to maintain sufficient equity and liabilities that are capable of credibly bearing losses in resolution. This will help ensure that when banks, building societies and investment firms fail and are of a size or nature that makes insolvency an unsuitable option, their failure can be managed by the use of resolution powers in a way that minimises risks to financial stability and disruption to critical services and without recourse to public funds.

During the financial crisis, governments felt compelled to bail out failing banks rather than risk the negative consequences that a disorderly failure would have had on the wider economy and financial system if the bank had been placed into insolvency. At that time there were no effective arrangements for resolution in place.

Following the crisis, there have been a number of legislative changes to build comprehensive resolution frameworks to deal with bank failure and remove the public subsidy for banks that have been considered "too big to fail". The framework provides the resolution authorities with powers either to 'bail-in' shareholders and creditors of the failed firm to allow its critical functions to continue or to transfer these critical functions to an acquirer.

The role of MREL in this resolution framework is to make these resolution strategies workable by ensuring that there are equity and liabilities within the firm that can credibly absorb losses and recapitalise the businesses that need to continue operating.

Effective arrangements for resolving banks that fail materially reduces both the probability and costs of financial crises. Moreover, as noted in the Financial Policy Committee's "Framework of capital requirement for UK banks"[1], effective resolution arrangements have been assessed to reduce the appropriate equity requirement for the banking system as a whole by about 5% of risk-weighted assets.

Mark Carney, Governor of the Bank of England said:

"The implementation of MREL is a crucial step forward in ensuring that any bank, large or small, carries sufficient resources to be resolved in an orderly way, without recourse to public subsidy and without disruption to the wider financial system."

MREL can be satisfied by a combination of regulatory capital and certain long term unsecured debt resources. For firms that have a bail-in strategy, resources satisfying MREL requirements must be subordinate to operating liabilities of the firm.

MREL is the sum of two components:

- a loss absorption amount: to cover losses up to and in resolution; and
- a recapitalisation amount: to enable the firm (or parts of it) to continue to meet conditions for authorisation and maintain market confidence as necessary following resolution.

The Bank will base the loss absorption component of MREL on the minimum going-concern capital requirement set by the PRA (or FCA for firms regulated solely by the FCA). Currently, this comprises Pillar 1 (the minimum capital requirement that firms must meet at all times to comply with the Capital Requirements Regulation) plus Pillar 2A, which covers risks not captured or not adequately captured in Pillar 1, or any applicable leverage ratio if that is higher.

The recapitalisation component will be based on a firm's recapitalisation needs post resolution as determined by the PRA as the supervisory authority and any additional requirements necessary to maintain market confidence. The recapitalisation component can be satisfied with capital maintained in excess of the loss absorption amount or qualifying unsecured debt instruments with a maturity of above 1 year.

The Bank will set MREL on a firm-specific basis, depending on the resolution strategy for the firm. The Bank intends to take a proportionate approach, with the strategy driven by a range of factors, including a firm's size, the scale of its critical economic functions and the complexity of transferring these activities in resolution.

[1] http://www.bankofengland.co.uk/publications/Documents/fsr/2015/fsrsupp.pdf

- For firms which need a bail-in strategy to continue operating, the recapitalisation amount is likely to be at least equal to existing Pillar 1 plus Pillar 2A capital requirements.

- For firms for which part of the business could be transferred to a private sector purchaser or temporarily to a bridge bank in resolution, the Bank proposes to set a recapitalisation amount that may be lower than existing Pillar 1 plus Pillar 2A capital requirements.

- For firms which can be placed into insolvency their recapitalisation needs will be zero.

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Notes to Editors:

The EU Bank Recovery & Resolution Directive (BRRD) requires that, from 1 January 2016, resolution authorities (in the UK, this is the Bank of England) must set an MREL for all banks, building societies and 730k investment firms.

The Bank's consultation will run until 11 March 2016, with an intention to publish a Statement of Policy in Q2 2016.

The Bank will provide firms with an indication of their prospective 2020 MREL during 2016, and will set MRELs on a transitional basis until 1 January 2020.

The MREL framework is consistent with the Financial Stability Board's standard for Total Loss Absorbing Capacity, which applies to G-SIBs only and must also be set on a firm-specific basis, subject to a common minimum floor. For G-SIBs, MREL will be set consistently with the FSB's TLAC standard: G-SIBs will not have a TLAC requirement that is separate or different to their MREL.

Alongside the Bank's MREL CP, the PRA has published a consultation paper on the interaction between MREL and capital buffers and how it would treat a breach of MREL.
http://www.bankofengland.co.uk/pra/Pages/publications/cp/2015/cp4415.aspx