



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP44/15

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

December 2015

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Responses are requested by Friday, 11 March 2016.

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1 Overview

1.1 This consultation paper (CP) sets out the Prudential Regulation Authority's (PRA's) proposals regarding the relationship between the minimum requirement for own funds and eligible liabilities (MREL) and regulatory buffers. The CP also sets out the PRA's proposals regarding the relationship between MREL and the PRA's Threshold Conditions, which provide the minimum requirements that firms must meet in order to be permitted to carry on the regulated activities in which they engage.

1.2 Alongside this CP, the Bank of England (the Bank) is consulting on its approach to setting MREL in line with relevant legislation¹. Readers should consider the Bank's consultation and proposed Statement of Policy in light of the PRA's proposals, and vice versa.

1.3 This CP is relevant to all PRA-regulated banks, building societies and PRA-designated investment firms ('firms').

1.4 With regard to regulatory buffers, chapter 3 covers the PRA's proposed relationship between MREL and:

- risk-weighted capital buffers: derived from the Capital Requirements Directive and Capital Requirements Regulation (jointly 'CRD IV')² and the PRA buffer derived from firm-specific capital requirements set by the PRA;³ and
- leverage buffers: buffers that form part of the UK leverage ratio framework as explained in the PRA Policy Statement (PS) 27/15 'Implementing a UK leverage ratio framework.'⁴

1.5 The PRA proposes that firms should not be able to double count common equity tier 1 (CET1) capital towards, on the one hand, MREL, and, on the other, risk-weighted capital and leverage buffers. This preserves the buffers' purpose of providing going concern loss absorbency. Depending on their business model and liability structure, firms may need to increase financial resources to avoid double counting.

1.6 With regard to Threshold Conditions, chapter 4 covers the PRA's proposals that a firm 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. It is important to note that a breach of MREL does not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy the Threshold Conditions.

1.7 The PRA has considered the Financial Stability Board's (FSB) total loss absorbing capacity (TLAC) standard⁵ when proposing the policies explained in this CP. The policies are aligned with the TLAC proposals not to double count CET1 capital towards, on the one hand, TLAC, and, on the other, regulatory buffers. They are also aligned with the TLAC proposals to treat a

1 See 'The Bank of England's approach to setting a minimum requirements for own funds and eligible liabilities (MREL)', December 2015; www.bankofengland.co.uk/financialstability/Pages/role/risk_reduction/srr/planning.aspx.

2 The Capital Requirements Regulation (575/2013) (CRR) and Capital Requirements Directive (2013/36/EU) (CRD), jointly 'CRD IV'.

3 See PS17/15, 'Assessing capital adequacy under Pillar 2', July 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1715update.aspx.

4 See PS27/15, 'Implementing a UK leverage ratio framework', December 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2715.aspx.

5 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.

breach, or likely breach, of TLAC as seriously as a breach or likely breach of minimum regulatory capital requirements.

1.8 Chapter 5 considers the PRA's statutory obligations in relation to the proposed policies.

1.9 This consultation closes on Friday, 11 March 2016. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP44_15@bankofengland.co.uk.

2 The role of the minimum requirement for own funds and eligible liabilities (MREL) in the PRA's regulatory regime

About MREL

2.1 The Banking Act 2009 as amended (the Banking Act) requires the Bank, as UK resolution authority, to set MREL for relevant firms and groups (UK incorporated banks, building societies and those firms that deal as principal and are required to hold initial capital of €730,000 ('730k investment firms')) in consultation with the PRA as the competent authority.

2.2 MREL will be set in line with the provisions of the Banking Act, the Bank Recovery and Resolution Directive (BRRD) and the MREL Draft Regulatory Technical Standards (RTS).¹ The Bank has considered the FSB's TLAC standard when setting MREL.

2.3 The Bank has proposed that it will calculate MREL on a firm-specific basis as the sum of two components: a loss absorption amount and a recapitalisation amount. The loss absorption amount is the amount needed to absorb losses up to and in resolution, whilst the recapitalisation amount is the amount needed to recapitalise the firm in resolution as necessary to meet the Banking Act resolution objectives, including the preservation of critical economic functions.

2.4 Both the loss absorption and the recapitalisation amounts of MREL will be based on the firm's risk weighted capital requirements or any applicable leverage ratio requirement, depending on whether the risk weighted capital or the leverage constraint is higher. Please refer to the Bank's proposals in 'The Bank of England's approach to setting MREL'.²

MREL will be complementary to the capital and leverage regimes

2.5 By 1 January 2020, firms' capital requirements will be influenced by a regulatory regime composed of three elements: CRD IV as implemented in the United Kingdom;³ the leverage ratio framework⁴ and MREL.

2.6 MREL has a similar role to the CRD IV and leverage ratio frameworks in safeguarding financial adequacy and the safety and soundness of firms, through requiring the loss absorbing amount described above, but MREL's further recapitalisation amount can act as an additional requirement on firms.

2.7 In contrast to the CRD IV and leverage ratio frameworks, firms can meet MREL by counting eligible liabilities⁵ in addition to CET1 and non-CET1 regulatory capital. This reflects the potential for creditors of a firm being exposed to losses and their debt instruments converted to equity to recapitalise the firm as necessary.

1 The MREL RTS will be binding on the Bank of England once adopted by the European Commission as regulation. 'The Bank's approach to setting MREL' has been prepared on the basis of the EBA's final draft RTS published on 3 July 2015. The Bank will review its approach to setting MREL to ensure it is compatible with the MREL RTS as adopted by the European Commission.

2 'The Bank of England's approach to setting MREL', December 2015, www.bankofengland.co.uk/financialstability/Pages/role/risk_reduction/srr/planning.aspx.

3 See PS7/13 'Strengthening capital standards: implementing CRD IV, feedback and final rules', December 2013; www.bankofengland.co.uk/pr/Pages/publications/implementcrdiv.aspx; PS3/14 'Implementing CRD IV: capital buffers', April 2014; www.bankofengland.co.uk/pr/Pages/publications/capitalbuffers.aspx and PS 17/15, 'Assessing capital adequacy under Pillar 2', July 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1715.aspx.

4 See PS27/15, 'Implementing a UK leverage ratio framework', December 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2715.aspx.

5 As set out in the 'Bank of England's approach to setting MREL', MREL can be met with regulatory capital and other long term liabilities which are: (a) in scope of bail-in; (b) not subject to preference in insolvency and (c) do not contain certain features which are likely to make them more difficult to bail-in or otherwise expose to loss in resolution.

2.8 In practice, this means that MREL will be an additional obligation, alongside the tests to meet the capital and leverage minimum requirements. Whether the introduction of MREL will cause firms to change the nature of their balance sheets will depend on the composition of their balance sheets. A firm with substantial eligible liabilities may need to make no changes. A firm with fewer eligible liabilities may need to issue new ones, convert existing ineligible liabilities to make them eligible or raise additional regulatory capital to count towards MREL.

2.9 Both the CRD IV and the leverage ratio framework minimum requirements are supplemented by buffer requirements. MREL as a requirement of the BRRD, designed to enable effective resolution, does not address the relationship between MREL and buffers. Chapter 3 considers this relationship and sets out the PRA's proposed policy in relation to MREL and buffers.

3 The relationship between MREL and buffers

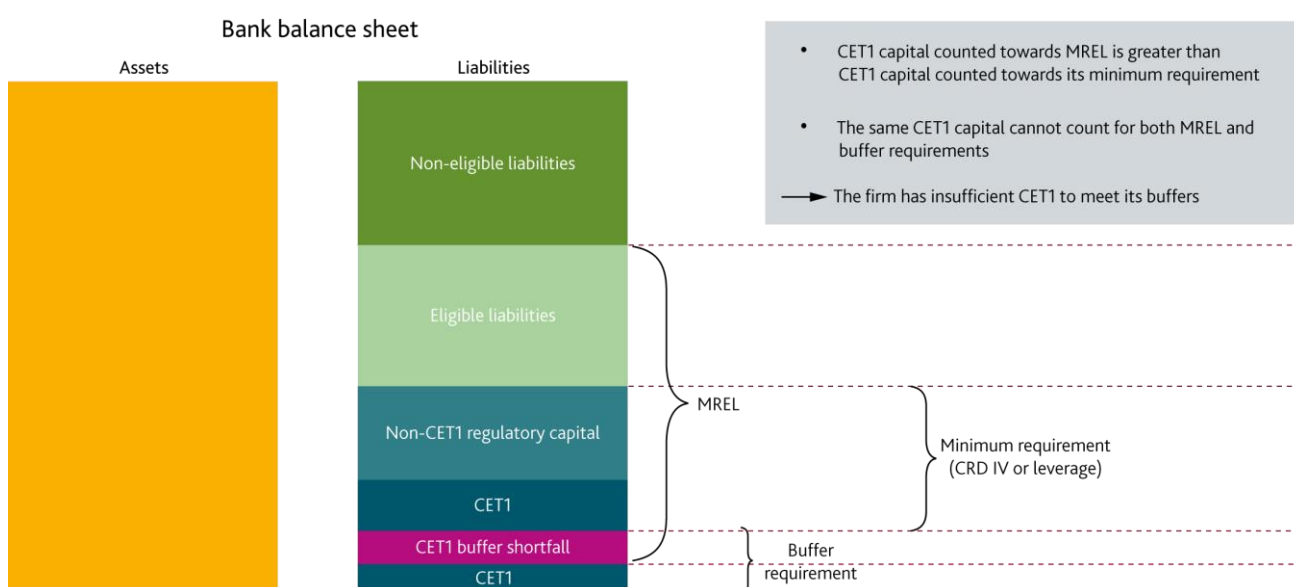
3.1 MREL is a minimum standard that firms must meet at all times in the same way as they must meet CRD IV and the leverage ratio minimum requirements.

3.2 Buffers are intended to ensure firms maintain a sufficient amount of CET1 capital above their regulatory minima, so that firms can withstand periods of stress. The relationship between the minimum risk-weighted capital requirements and the corresponding buffers is set out in CRD IV as implemented by the PRA’s rules¹ and supervisory statements.² The relationship between the minimum leverage ratio requirement and the corresponding buffers is set out in Supervisory Statement SS45/15 ‘The UK leverage ratio framework’,³ in line with the Bank’s Financial Policy Committee’s (FPC) Direction and Recommendation to implement a UK leverage ratio framework. In both cases, firms cannot double count CET1 towards their buffers and minimum requirements.

3.3 Similarly, the PRA expects firms not to double count CET1 capital towards, on the one hand, MREL, and, on the other, buffers. This means that firms which count CET1 towards MREL will also need to have sufficient CET1 to meet their buffers.

3.4 A potential impact of the proposed policy is illustrated in **Figure 1** below, which considers a stylised balance sheet for a firm.

Figure 1:



¹ See the Capital Buffers Part of the PRA Rulebook.
² See SS 31/15 ‘The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)’, July 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss3115.aspx; and SS 6/14 ‘Implementing CRD IV: capital buffers’, April 2014; www.bankofengland.co.uk/pr/Pages/publications/capitalbuffers.aspx.
³ See SS45/15, ‘The UK leverage ratio framework’, December 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss4515.aspx.

3.5 In this 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.

3.6 The firm in the figure 1 is double counting the same CET1 between MREL and buffers (shown as the 'CET1 buffer shortfall'). The PRA's proposed policy would prevent this, requiring the firm to change its balance sheet (most likely by increasing eligible liabilities) to ensure its buffer requirements are met.

3.7 The setting of MREL need not always have an impact on a firm's ability to meet its buffers, as it could meet MREL with eligible liabilities, non-CET1 regulatory capital or CET1.

3.8 The proposed policy of no double counting applies to buffers derived from the risk-weighted capital framework in exactly the same way as it applies to buffers derived from the leverage ratio framework. The buffers from only one of the regimes will bind on firms at any one time. Owing to the different legal requirements governing the two regimes, this chapter and the draft supervisory statement in the appendix consider the risk-weighted capital buffers and the leverage buffers separately. More specifically, the PRA proposes to implement the proposed policy in relation to risk-weighted buffers through guidance, reflecting the use of guidance to set the PRA buffer, and to implement the proposed policy in relation to leverage buffers through the use of PRA powers under section 55M of the Financial Services and Markets Act (FSMA), reflecting the use of regulatory requirements to set the leverage ratio buffers.

Proposed policy on MREL and capital buffers

3.9 The risk-weighted capital buffer framework includes the CRD IV combined buffer¹ and the PRA buffer.²

3.10 The PRA proposes to adopt a policy set out in the supervisory statement in the appendix, providing that firms are expected not to meet their CRD IV combined buffer or the PRA buffer with any CET1 capital counted towards their MREL requirement.

3.11 Further, if a firm does not have, or expects that it will not have, sufficient CET1, in addition to any CET1 counted towards its MREL requirement, to meet its CRD IV combined buffer and the PRA buffer, it should notify the PRA of this as soon as practicable, consistent with Fundamental Rule 7,³ explaining why this has happened or is expected to happen.

3.12 A firm which has insufficient CET1 to meet its CRD IV combined buffer or PRA buffer in addition to any CET1 counted towards the required level of MREL can expect enhanced supervisory action and should prepare a capital restoration plan. If the PRA is not satisfied with the capital restoration plan, or with the firm's reasons for the shortfall, it will consider using its firm-specific powers under section 55M of FSMA to require a firm to take steps to strengthen its capital position. Such steps could include restricting or prohibiting distributions where that is appropriate and proportionate.

1 As set out in SS 6/14 'Implementing CRD IV: capital buffers', April 2014, the combined buffer comprises the countercyclical capital buffer, the capital conservation buffer, the buffer for Global Systemically Important Institutions (G-SII buffer) and the systemic risk buffer, where applicable. The CCoB and the G-SII buffer will be phased in from 1 January 2016 until 2019. The systemic risk buffer is to be implemented as of 2019; See www.bankofengland.co.uk/pr/Pages/publications/capitalbuffers.aspx.

2 See PS17/15 'Assessing capital adequacy under Pillar 2', July 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1715.aspx.

3 Fundamental Rule 7 states that a firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.

Proposed policy on MREL and leverage ratio buffers

3.13 The FPC directed the PRA on 24 June 2015 to implement a UK leverage ratio framework, in relation to major UK banks and building societies on a consolidated basis. The PRA published its PS on the implementation of the FPC's direction and recommendation on leverage ratio tools in December 2015 (PS27/15 'Implementing a UK leverage ratio framework').¹ The leverage ratio framework comprises a 3% minimum leverage ratio requirement, a countercyclical leverage ratio buffer (CCLB) and a G-SII additional leverage ratio buffer (G-SII ALRB). In this CP the PRA makes proposals on the relationship between MREL and the leverage ratio buffers.

3.14 The PRA proposes to adopt a policy, set out in the supervisory statement in the appendix, to prevent double counting of CET1 between MREL and any applicable leverage ratio buffers by imposing firm-specific requirements (in the case of both the CCLB and the ALRB) providing that a firm must not count CET1 used to meet its MREL towards meeting its leverage ratio buffers.

3.15 The requirements would be set by the PRA in respect of specific firms by use of the PRA's powers under section 55M of FSMA. Relevant firms would be invited to apply for the requirements. If a firm invited to apply for the requirements did not do so, the PRA would consider using its powers under section 55M(3) of FSMA to impose the requirements on its own initiative.

1 See PS27/15, 'Implementing a UK leverage ratio framework', December 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2715.aspx.

4 The relationship between MREL and Threshold Conditions

4.1 This chapter explains the proposed PRA policy on the impact of a breach of MREL on Threshold Conditions.

4.2 As noted in chapter 1 of ‘The Bank of England’s approach to setting MREL’ and in chapter 2 of this CP, MREL will be a minimum requirement. MREL may impose a more binding constraint on firms than minimum risk-weighted capital requirements and any applicable minimum leverage ratio requirement. An intention of the PRA’s policy, as described in chapter 3, is that a breach of MREL cannot occur until after the buffers have been fully depleted.

4.3 The PRA’s statutory Threshold Conditions are designed to promote safety and soundness and are crucial to the operation of the PRA’s regulatory regime. Among other things, and in broad terms, they require firms to have an appropriate amount and quality of capital and to conduct their business prudently. The PRA expects firms to meet, and to continue to meet, these specific requirements as well as the overriding principle of safety and soundness.

4.4 To satisfy the condition that its business is conducted in a prudent manner (Threshold Condition 5D),¹ a firm must have appropriate financial resources. To have appropriate financial resources, the firm’s assets must be appropriate given its liabilities. MREL is therefore directly relevant to Threshold Condition 5D.

4.5 The PRA assesses firms against Threshold Conditions on a continuous basis and proposes to take into account a breach by a firm of its MREL requirement in assessing the firm against Threshold Conditions.

4.6 The PRA proposes in the supervisory statement in the appendix that if a firm is in breach of MREL, the firm 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.

4.7 However, the relationship would not be automatic. A breach of MREL would not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

¹ See 5D, Part 1E, Schedule 6, FSMA.

5 The PRA's statutory obligations

5.1 In discharging its general function of determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as is reasonably possible, act in a way that advances its general objective to promote the safety and soundness of PRA-authorized persons and facilitates effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities (as a secondary objective).¹ The PRA considers that the proposals in this CP will advance the PRA's general objective.

5.2 The PRA must also have regard to the regulatory principles set out in FSMA. The PRA considers the proposals in this CP to be compatible with the regulatory principles, the most relevant being proportionality, the desirability where appropriate of the PRA exercising its functions in a way that recognises differences in the nature and objectives of businesses carried on by different firms, the desirability of sustainable growth and transparency.

Cost benefit and competition analysis

5.3 This section sets out an analysis of the costs and benefits of the proposed relationship between MREL and buffers, and MREL and Threshold Conditions respectively.

5.4 The level of MREL will be set by the Bank as resolution authority in consultation with the PRA. 'The Bank of England's approach to setting MREL' considers the calibration of MREL and the corresponding impact thereof. Readers should note that the impact of the PRA's proposed policy is distinct from the costs and benefits of the MREL regime in its entirety. A detailed cost-benefit analysis of MREL as a whole is set out in 'The Bank of England's approach to setting MREL'.

5.5 The markets within which the affected firms operate include those associated with credit intermediation (eg retail and commercial lending), as well as wholesale market activity (eg investment banking) and payment services.

MREL and buffers – costs and benefits

5.6 Under the PRA's proposed approach, firms should not double count CET1 capital towards, on the one hand, MREL, and, on the other, risk-weighted capital buffers and leverage buffers.

Costs

5.7 First, the impact on firms depends on the liability structure of their balance sheets – there would be no impact on a firm with sufficient eligible liabilities to meet MREL even in the absence of this policy. Secondly, firms can react to MREL shortfalls in different ways, eg issue more eligible liabilities, convert existing ineligible liabilities to make them eligible or raise additional regulatory capital. It is therefore difficult to quantify the firm-specific costs of this policy.

5.8 However, the maximum potential cost of the policy on a firm can be estimated. The inability to count CET1 towards MREL and buffers simultaneously means the maximum impact of the policy on the firm will be equal to the size of the buffers imposed – if MREL is set at a level where it must count CET1 which might otherwise be counted towards buffers, the firm will need to adjust its balance sheet. The least costly way would most likely be to issue MREL

¹ See s.2B (1), s.2B(2) FSMA and s.2H FSMA.

eligible liabilities. These would count towards MREL, thereby making CET1 available to count towards buffers.

5.9 Buffers themselves will differ on a firm-by-firm basis. For a global systemically important bank they might typically be of the order of 4.5% of risk-weighted assets, under the assumption that the countercyclical capital buffer is set at zero¹. For a smaller, non-systemic institution, buffers are likely to be much lower in the order of 2.5% (the equivalent of the capital conservation buffer imposed by CRD IV). The PRA therefore estimates that the approximate impact of the policy will be in the range of 2.5%-4.5% of risk-weighted assets. Again, it is worth noting that firms can respond to this impact in a number of ways (by issuing more eligible liabilities, converting ineligible liabilities into eligible ones or issuing non-regulatory CET1 capital or CET1 capital).

Benefits

5.10 The proposed policy should help ensure that the buffers' purpose of providing going concern loss absorbency is preserved. The cost-benefit analysis of the PRA's policies on buffers is set out in CP5/13 'Strengthening capital standards: implementing CRD IV'² and in 'The Financial Policy Committee's review of the leverage ratio'³ respectively.

5.11 The PRA also expects its proposed policy to lead to reduced uncertainty about the relationship between MREL and buffers. The cost benefit analysis of the Bank's policies on MREL is set out in the 'Bank of England's approach to setting MREL.'

5.12 The PRA expects the benefits of the proposed policy to outweigh the costs.

MREL and Threshold Conditions – costs and benefits

5.13 Under the proposed approach, if a firm is in breach of MREL, it 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.

5.14 The proposed policy would reinforce the policy that MREL is a minimum requirement to be met at all times and is designed to increase the chances that a failing firm can be successfully resolved.

Costs

5.15 The PRA does not expect there to be incremental costs, in terms of an increased capital requirement, as a result of this policy. There may be costs associated with checking compliance with the proposed policy but the PRA does not expect them to be of material significance.

Benefits

5.16 The PRA expects a number of material benefits as a result of this policy, as follows: contributing to the financial adequacy and resolvability of firms; reduced uncertainty as to how breaches of MREL would be treated; ensuring a coherent regime in which the PRA's approach to treating breaches of a firm's MREL is aligned to the PRA's treatment of a firm's deviation from the terms of its individual capital guidance; and ensuring that the intended benefits of MREL are realised, thus reducing the risk of regulatory failure.

1 See 'Supplement to the December 2015 Financial Stability Report: The framework of capital requirements for UK banks', December 2015; www.bankofengland.co.uk/publications/Pages/fsr/2015/dec.aspx.

2 See CP5/13 'Strengthening capital standards: implementing CRD IV', August 2013; www.bankofengland.co.uk/pr/Pages/publications/implemcrdiv.aspx.

3 'The Financial Policy Committee's review of the leverage ratio', October 2014; www.bankofengland.co.uk/financialstability/Documents/fpc/fs_lrr.pdf.

5.17 These benefits should allow for a better understanding of the regime by firms and market participants and ensure that the PRA can take action in situations where it has legitimate concerns about a breach of MREL requirements.

5.18 The PRA expects the benefits of the proposed policy to outweigh the costs.

5.19 The PRA and the Bank have also considered the macroeconomic impact of the proposed policy. Please refer to the 'Impact assessment' section of 'The Bank of England's approach to setting MREL' for a full analysis. If, as a result of the policy, firms need to raise additional funding, this could raise the weighted average cost of funding for the industry. To the extent that this is passed through to the cost of lending, this would tend to reduce the volume of lending by institutions. This in turn may lead to lower aggregate output. But given the overall macroeconomic estimate for the MREL regime in its entirety, 3 basis points of GDP, the PRA anticipates the macroeconomic impact of this specific policy not to be of material significance.

Impact on competition

5.20 The policies proposed in this CP cover only the relationship between MREL and buffers, and MREL and threshold conditions. The impact of the MREL framework is set out in 'The Bank of England's approach to setting MREL.' As MREL is a function of capital requirements, the evolving capital requirements framework may in turn impact MREL. This is further discussed in 'Box 2: MREL and the PRA's minimum capital requirements' in the Bank's consultation and is not covered by this CP.

5.21 The PRA considers that the policies proposed in this CP will advance its general objective of promoting the safety and soundness of firms: in particular, allowing firms to double count CET1 capital towards, on the one hand, MREL, and, on the other, buffers, would undermine the buffers' role of providing going concern loss absorbency and would not advance the PRA's general objective of promoting the safety and soundness of firms.

5.22 When discharging this general objective, the PRA must also act in a way which facilitates effective competition so far as is reasonably possible, as a secondary objective. In this context, the PRA's analysis of the potential impact of the policies proposed in this CP suggests that not all firms may be impacted equally:

- Firms for which insolvency proceedings are the preferred resolution strategy will not be affected by the proposed policy of no double counting of CET1 between MREL and buffers, as it is not proposed that MREL will be set in excess of existing capital requirements;
- Firms for which partial transfer or bail-in is the preferred resolution strategy will be affected to a greater or lesser extent depending on four factors for each firm: (i) the level of MREL set and the firm's current level of capital and eligible liabilities (ii) the size of the firm's buffer requirements; (iii) the firm's access to debt and capital markets; and (iv) how the firm chooses to address any shortfall in meeting either the MREL or buffer requirements.

5.23 It is worth noting, however, that mid-sized firms may have smaller buffer requirements, as they are not subject to the global systemically important institutions buffer or to the systemic risk buffer.

5.24 Some small-to-mid-sized firms, which will have MREL requirements, have not in the past had access to the same range of markets for financing as larger firms. Certain small-to-mid-sized firms, including some mutuals, may therefore need to satisfy MREL requirements via

more expensive equity or other liabilities and may also find it more difficult than larger firms to re-structure their funding in a way that is MREL-eligible. Drawing on the responses to this CP, and taking into account its commitment to proportionality in its approach, the PRA will reach a view on the impact on competition of the proposed policies on the relationship between MREL and buffers, and MREL and threshold conditions.

Equality and diversity

5.25 In making its rules and establishing its practices and procedures, the PRA may not act in an unlawfully discriminatory manner. It is required, under the Equalities Act 2010, to have due regard to the need to eliminate discrimination and promote equality of opportunity in carrying out its policies, services and functions.¹ To meet this requirement, the PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

¹ Equalities Act 2010, section 149(1).

Appendix- Draft supervisory statement: The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions

1 Introduction

1.1 This supervisory statement is aimed at Prudential Regulation Authority (PRA)-regulated banks, building societies and PRA designated investment firms ('firms').

1.2 This supervisory statement provides further detail in relation to the high level expectations outlined in 'The PRA's approach to banking supervision'.¹ As set out in the approach document, firms are expected to engage directly with policy material, including supervisory statements, and determine — bearing in mind the overarching principle of safety and soundness — whether they meet the PRA's expectations.

1.3 This statement sets out the PRA's expectations on the relationship between the minimum requirement for own funds and eligible liabilities (MREL) and both the capital and leverage ratio buffers, as well as the implications that a breach of MREL would have for the PRA's consideration of whether a firm is failing, or likely to fail, to satisfy the Threshold Conditions.

1.4 This supervisory statement should be read in conjunction with the Bank of England's statement of policy on MREL and PRA supervisory statements on capital buffers² and leverage buffers.³

2 Buffers

Capital buffers

2.1 The PRA's capital buffer framework comprises the Capital Requirements Directive and Regulation (jointly 'CRD IV') combined buffer⁴ (which includes the capital conservation buffer, the countercyclical capital buffer, the buffer for Global Systemically Important Institutions and the systemic risk buffer – if applicable to a firm), and the PRA buffer.⁵

2.2 The PRA expects firms not to meet their CRD IV combined buffer or the PRA buffer with any CET1 capital counted towards their MREL requirement, which is also a minimum. While firms could meet MREL with CET1, they do not need to meet it with CET1. See 'The Bank of England's approach to setting MREL'⁶ for details.

1 'The Prudential Regulation Authority's approach to banking supervision', June 2014; www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1406.pdf.

2 See SS6/14 'Implementing CRD IV: capital buffers', April 2014; www.bankofengland.co.uk/pr/Pages/publications/capitalbuffers.aspx. and PRA Supervisory Statement (SS31/15 UPDATE) 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', July 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss3115.aspx.

3 See SS45/15, 'The UK leverage ratio framework', December 2015; www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss4515.aspx.

4 The Capital Requirements Regulation (575/2013)(CRR) and Capital Requirements Directive (2013/36/EU)(CRD), jointly 'CRD IV'.

5 See PS17/15 'Assessing capital adequacy under Pillar 2', July 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1715.aspx.

6 The Bank of England's approach to setting MREL', December 2015; www.bankofengland.co.uk/financialstability/Pages/role/risk_reduction/srr/planning.aspx.

2.3 If a firm does not have, or expects that it will not have, sufficient CET1, in addition to the CET1 counted towards its MREL requirement, to meet its CRD IV combined buffer and the PRA buffer, it should notify the PRA of this as soon as practicable, consistent with Fundamental Rule 7,¹ explaining why this has happened or is expected to happen.

2.4 A firm which does not have or expects that it will not have sufficient CET1, in addition to the CET1 counted towards its MREL requirement, to meet its CRD IV combined buffer or the PRA buffer can expect enhanced supervisory action and should prepare a capital restoration plan. If the PRA is not satisfied with the capital restoration plan, or with the firm's reasons for the shortfall, it will consider using its firm-specific powers under section 55M of the Financial Services and Markets Act 2000 (FSMA) to require a firm to take steps to strengthen its capital position. Such steps could include restricting or prohibiting distributions where that is appropriate and proportionate.

Leverage ratio buffers

2.5 The PRA's leverage ratio framework includes two leverage ratio buffers: a countercyclical leverage ratio buffer (CCLB) and a G-SII additional leverage ratio buffer (G-SII ALRB).²

2.6 The PRA expects firms not to meet their leverage ratio buffers with any CET1 capital counted towards their MREL requirement. If a firm is subject to a CCLB or G-SII ALRB, the PRA will invite the firm to apply for a requirement under section 55M of FSMA preventing the firm from counting CET1 used to meet its MREL requirement towards its leverage ratio buffer(s). If a firm does not apply for such a requirement, the PRA will consider using its powers under section 55M(3) of FSMA to impose the requirements on its own initiative.

3 Threshold Conditions

3.1 The PRA's statutory Threshold Conditions, which set out the minimum requirements that firms must meet in order to be permitted to carry on the regulated activities in which they engage, are designed to promote safety and soundness and are crucial to the operation of the PRA's regulatory regime.

3.2 Firms should expect the PRA to investigate whether any firm in breach of its MREL requirement is failing, or likely to fail, to satisfy the Threshold Conditions, with a view to taking further action as necessary. However, a breach by a firm of its MREL requirement does not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

¹ Fundamental Rule 7 states that a firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.

² See PS27/15 'Implementing a UK leverage ratio framework', December 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2715.aspx.