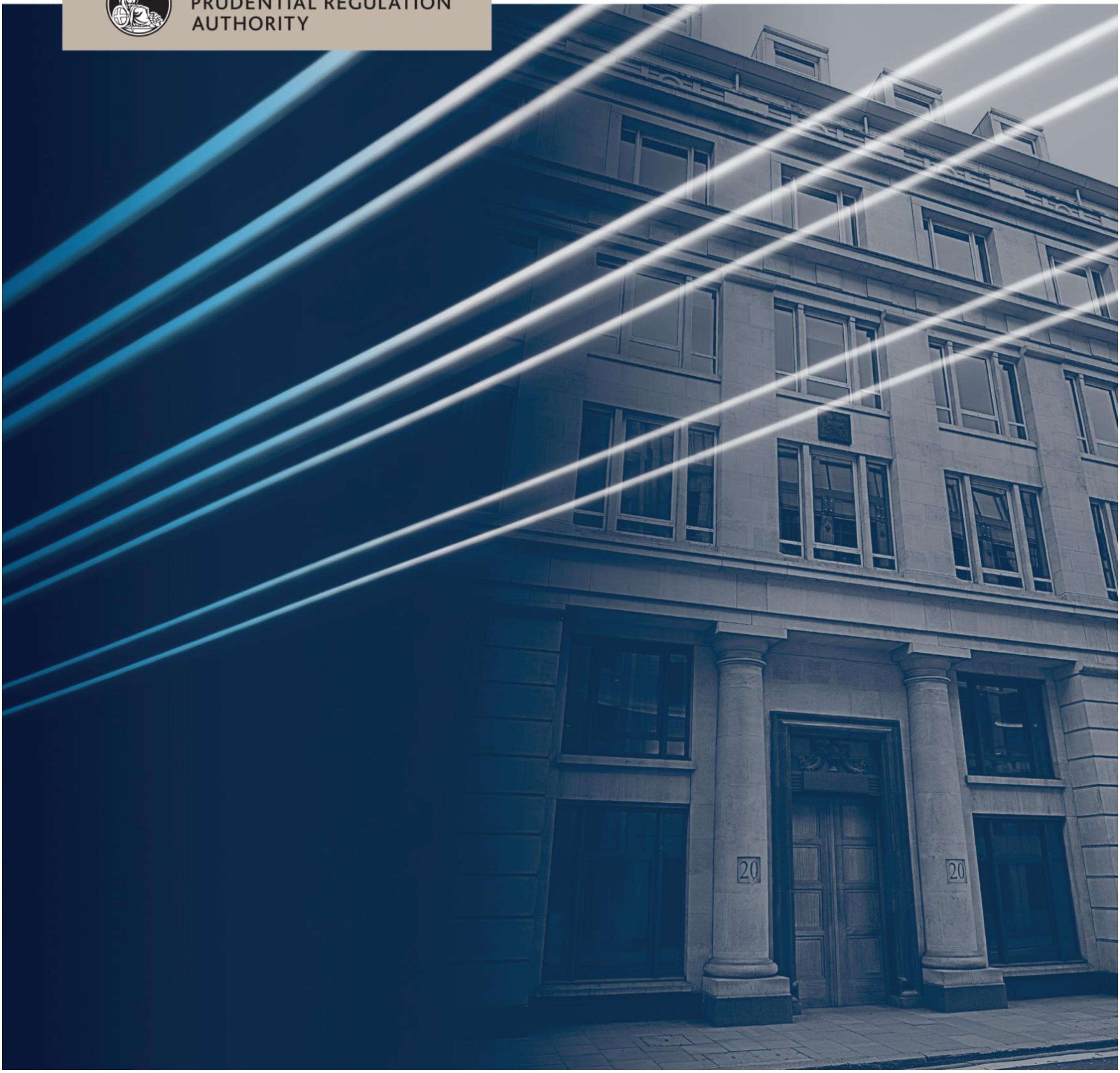
Supervisory Statement | SS16/16

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

November 2016

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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1 Introduction

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

1.2 This statement sets out the PRA's expectations on the relationship between the minimum requirement for own funds and eligible liabilities (MREL) and both 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.

1.3 This SS 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 SSs, and determine — bearing in mind the overarching principle of safety and soundness — whether they meet the PRA's expectations.

1.4 This SS should be read in conjunction with the Bank of England's (the Bank's) statement of policy on its approach to setting MREL[2] and PRA SSs on capital buffers[3] and leverage buffers.[4]

2 Buffers

Capital buffers

2.1 The PRA's capital buffer framework comprises the Capital Requirements Directive (2013/36/EU) and Capital Requirements Regulation (575/2013) (jointly 'CRD IV') combined buffer (which includes the capital conservation buffer, the countercyclical capital buffer, the Global Systemically Important Institutions (G-SII buffer) 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 common equity tier 1 (CET1) capital counted towards their MREL, which is also a minimum requirement to be met at all times. While firms could meet MREL with CET1, they do not need to meet it with CET1. See the Bank's statement of policy on its approach to setting MREL for details.

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, 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,[6] explaining why this has happened or is expected to happen.

1 Also referred to as the 'approach document', March 2016; www.bankofengland.co.uk/publications/Pages/other/pra/supervisoryapproach.aspx.

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

3 See SS6/14 'Implementing CRD IV: capital buffers', April 2014; www.bankofengland.co.uk/pra/Pages/publications/capitalbuffersss614.aspx, and SS31/15 UPDATE 'The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)', August 2015; www.bankofengland.co.uk/pra/Pages/publications/ss/2015/ss3115update.aspx.

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

5 See PS17/15 UPDATE 'Assessing capital adequacy under Pillar 2', August 2015; www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps1715update.aspx.

6 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.

2.4 A firm which does not have or expects that it will not have sufficient CET1, in addition to the CET1 counted towards its MREL, 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. Distributions restrictions will not apply automatically.

2.5 Where a firm does not have sufficient CET1 to meet its minimum capital requirements and the CRD IV combined buffer, automatic restrictions on distributions will apply under the Capital Buffers Part and firm-specific requirements.[1]

Leverage ratio buffers

2.6 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]

2.7 The PRA expects firms not to meet their leverage ratio buffers with any CET1 capital counted towards their MREL. 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 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.

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 or likely breach of its MREL is failing, or likely to fail, to satisfy the Threshold Conditions, with a view to taking further action as necessary. However, a breach or likely breach by a firm of its MREL does not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy Threshold Conditions.

4 Transitional arrangements

4.1 In the statement of policy on its approach to setting MREL, the Bank, as UK resolution authority, indicates that it expects to direct firms to comply with an end-state MREL from 1 January 2022. To ensure that firms make progress towards meeting their end-state requirements, the Bank expects to direct relevant firms to also meet an interim MREL. Please refer to Chapter 7 of the Bank statement of policy for these transitional arrangements.[3]

1 As stated in SS31/15 UPDATE and SS6/14, the PRA imposes requirements on firms under section 55M of FSMA to set the G-SII buffer (where applicable) and prevents firms from meeting their CRD IV combined buffer with any CET1 capital maintained to meet their individual capital guidance.
2 See PS27/15 'Implementing a UK leverage ratio framework', December 2015; www.bankofengland.co.uk/pra/Pages/publications/ps/2015/ps2715.aspx.
3 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL): Responses to Consultation and Statement of Policy', November 2016; www.bankofengland.co.uk/financialstability/Documents/resolution/mrelpolicy2016.pdf.

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

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

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