

Supervisory Statement | SS16/16

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

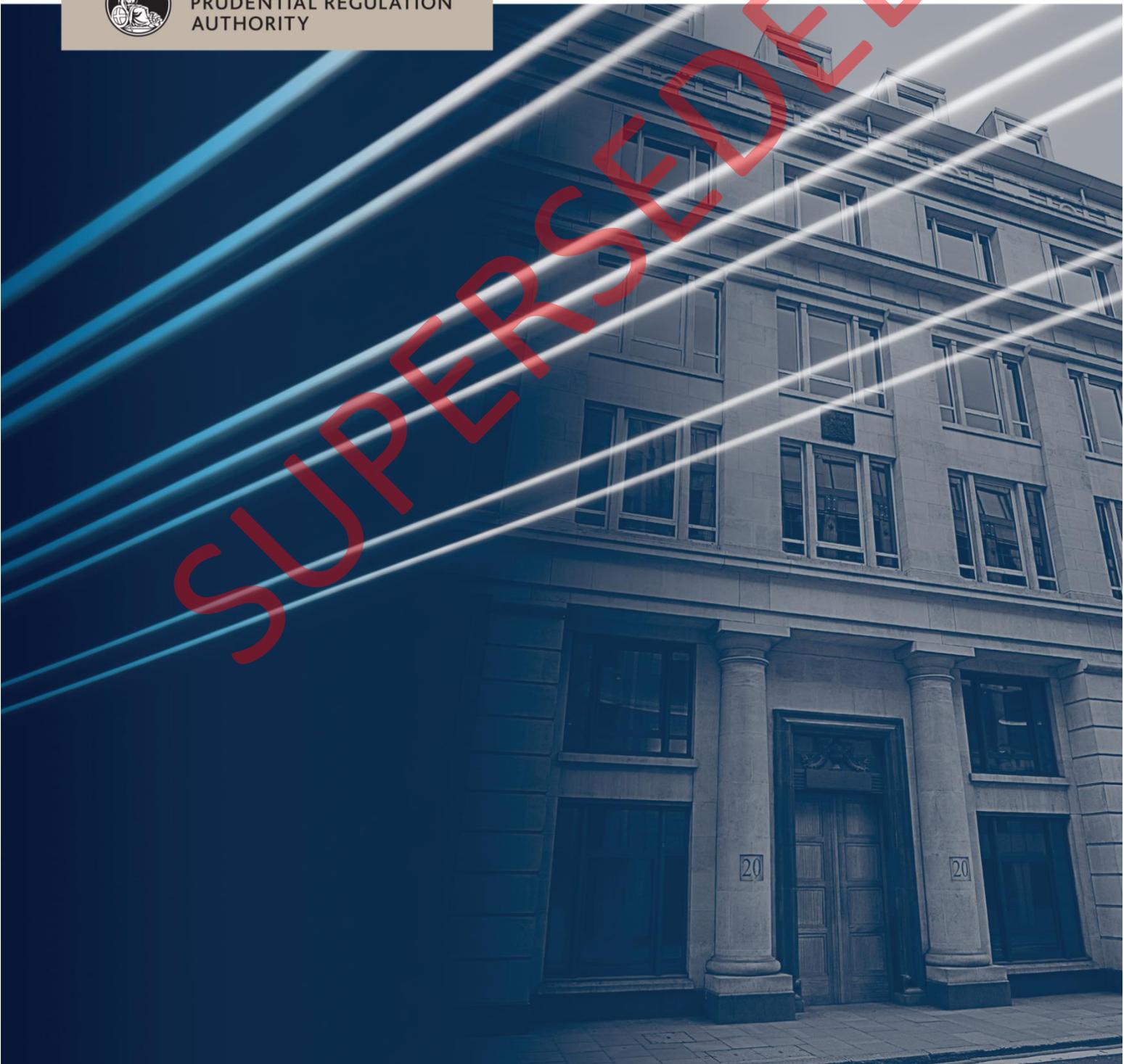
December 2017

(updating November 2016)



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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 MREL² and PRA SSs on risk-weighted capital buffers³ and leverage buffers.⁴

2 Buffers

Calculating an amount of common equity tier 1 capital (CET1) to meet buffer requirements that cannot also be counted to meet MREL

2.A The PRA expects firms to meet both MREL and maintain an amount of CET1 that reflects their risk-weighted capital and leverage buffers. The PRA expects firms not to double count CET1 towards both MREL and the amount reflecting the risk-weighted capital and leverage buffers. While firms can meet MREL with CET1, they do not have to meet it with CET1. See 'The Bank of England's approach to setting MREL'⁵ for details.

2.B The amount that reflects risk-weighted capital and leverage buffers should be calculated to be the amount of CET1 that a firm is required to maintain (in sterling terms) in addition to the largest minimum of either the risk-weighted capital or leverage regimes.⁶ Where the firm is not subject to the leverage regime, the amount will be equal to the applicable risk-weighted capital buffers and paragraphs 2.6, 2.6A, 2.7 and 2.7A will not be relevant.

1 Also referred to as the 'approach document', March 2016; www.bankofengland.co.uk/news?NewsTypes=65d34b0d42784c6bb1dd302c1ed63653&Taxonomies=973f7bc68fd74abca30287f8a0a15fa3&Direction=Latest.

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/prudential-regulation/publication/2014/implementing-crdiv-capital-buffers-ss, 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/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss.

4 See SS45/15 'The UK leverage ratio framework', December 2015; www.bankofengland.co.uk/prudential-regulation/publication/2015/the-uk-leverage-ratio-framework-ss.

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

6 The risk-weighted capital minimum is Pillar 1 plus Pillar 2A. The leverage minimum is the 3% (as at 27 July 2017) leverage ratio minimum requirement.

Risk-weighted 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.¹

2.2 Deleted.

2.2A The buffers are maintained in addition to minimum risk-weighted capital requirements.

2.3 If a firm does not have, or expects that it will not have, sufficient CET1, in addition to any own funds and liabilities counted towards its MREL, to meet the amount of CET1 calculated in paragraph 2.B, the firm will be considered to have used, or be about to use, the buffers of the regime where the total amount of capital required to meet minimum requirements plus buffers (risk-weighted capital or leverage) is largest.

2.4 Where that regime is the CRD IV regime, the firm should notify the PRA as soon as practicable, consistent with Fundamental Rule 7,² explaining why this has happened or is expected to happen. The firm 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 risk-weighted capital requirements and the CRD IV combined buffer, automatic restrictions on distributions will apply under the Capital Buffers Part and firm-specific requirements.³

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).⁴

2.6A The buffers are maintained in addition to minimum leverage requirements.

2.7 The PRA expects firms not to meet the amount of CET1 calculated in paragraph 2.B with any CET1 capital counted towards their MREL. If a firm is subject to, or becomes 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 the amount of CET1 calculated in paragraph 2.B. 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.

1 See PS17/15 UPDATE 'Assessing capital adequacy under Pillar 2', August 2015; www.bankofengland.co.uk/prudential-regulation/publication/2015/assessing-capital-adequacy-under-pillar-2.

2 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.

3 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.

4 See PS27/15 'Implementing a UK leverage ratio framework', December 2015; www.bankofengland.co.uk/prudential-regulation/publication/2015/implementing-a-uk-leverage-ratio-framework.

2.7A If a firm does not, or expects that it will not, have sufficient CET1, in addition to any own funds and liabilities counted towards MREL, to meet the amount of CET1 calculated in paragraph 2.B, the firm will be considered to have used, or be about to use, the buffers of the regime under which the total amount of capital required to meet minimum requirements plus buffers (risk-weighted capital or leverage) is largest.

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.¹

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.

1 '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.

Annex – SS16/16 updates

This annex outlines changes made to SS16/16 since its publication in PS30/16 ‘The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions’¹ in November 2016.

December 2017

This SS was updated following the publication of CP15/17 ‘The minimum requirement for own funds and eligible liabilities (MREL) – buffers’² to clarify that the expectations set in SS16/16 are not intended to create a different buffer requirement from that which is usable in the going concern regime. Specifically:

- paragraphs 2.A and 2.B have been added, and paragraph 2.2 has been deleted to clarify the PRA’s expectations regarding the amount of CET1 that firms should not count simultaneously towards buffer requirements and MREL (ie an amount equal to the buffer requirement which is usable in the going concern regime);
- paragraphs 2.2A and 2.6A have been added to be explicit that buffers are maintained in addition to the relevant minimum requirements;
- paragraphs 2.3, 2.4 and 2.7 have been amended, and paragraph 2.7A has been added to clarify the consequences of not maintaining sufficient CET1 to meet both the buffer requirement and MREL; and
- paragraphs 1.4, 2.5 and the title ‘Capital buffers’ have been updated to more consistently refer to ‘risk-weighted capital’ as opposed to just ‘capital’.

1 www.bankofengland.co.uk/prudential-regulation/publication/2015/implementing-a-uk-leverage-ratio-framework

2 www.bankofengland.co.uk/prudential-regulation/publication/2017/cp1517.aspx.