



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP15/17

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

July 2017



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Responses are requested by Friday 29 September 2017.

Please address any comments or enquiries to:

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1 Overview

1.1 This consultation paper (CP) sets out the Prudential Regulation Authority's (PRA's) proposed expectations with regard to the relationship between MREL and buffer requirements, as well as the consequences of not meeting these.

1.2 The CP proposes to update Supervisory Statement (SS) 16/16 'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions'¹ (see Appendix).

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

Background

1.4 In November 2016 the PRA published SS16/16, which sets out how the PRA views the relationship between MREL and the buffer requirements from the two going-concern regimes:

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

1.5 SS16/16 states that the PRA expects firms not to count Common Equity Tier 1 (CET1) capital towards both MREL and the buffer requirements.

1.6 Subsequently, the PRA has been asked about the situation where MREL is calibrated on the basis of one capital regime (eg leverage, in circumstances where the leverage requirement is larger than the risk-weighted requirement), but the largest requirement for buffers derives from the other regime (eg risk-weighted capital).

1.7 The PRA believes this situation applies to a very small number of firms at the time of writing. Nonetheless, this CP proposes to update the SS 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.

Responses and next steps

1.8 This consultation closes on Friday 29 September 2017. The PRA has chosen a short consultation period, as it wishes to provide certainty on the policy in a timely fashion. The PRA aims to publish the updated supervisory statement before the end of 2017. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP15_17@bankofengland.co.uk.

1 November 2016: www.bankofengland.co.uk/pr/Pages/publications/ss/2016/ss1616.aspx.

2 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 December 2015: www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps2715.aspx.

2 Proposals

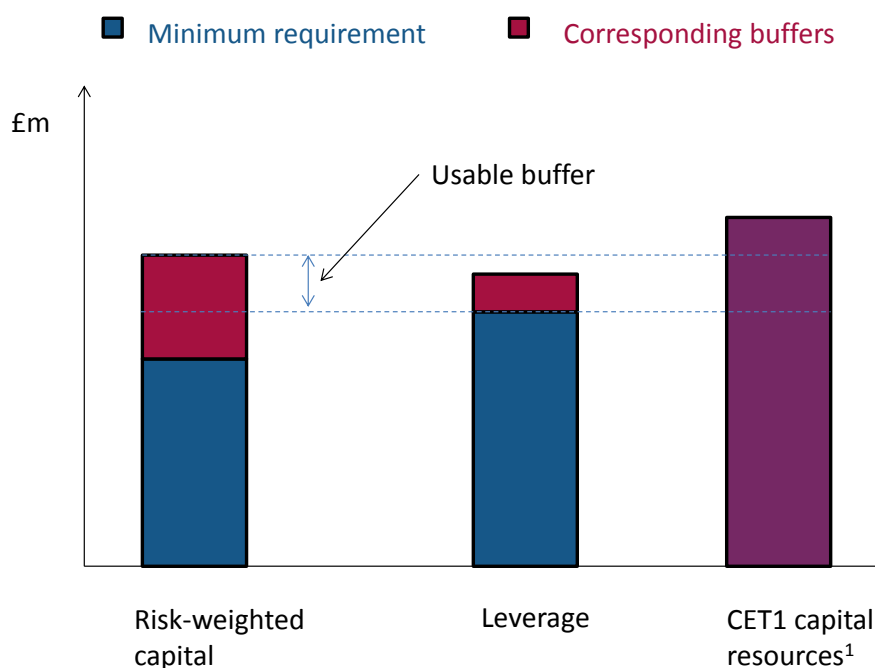
The relationship between MREL and buffers

2.1 MREL is a minimum requirement that applies alongside the minimum requirements of the risk-weighted capital and leverage regimes. In each case, a firm's failure to meet the minimum requirement may lead the PRA to consider whether that firm is meeting the PRA's Threshold Conditions, which firms must meet in order to be permitted to carry on the regulated activities in which they engage.

2.2 The purpose of SS16/16 is to ensure that CET1 capital buffers from the risk-weighted capital and leverage regimes continue to have effect following the introduction of MREL. The buffers help firms withstand stress before a minimum requirement is breached.

2.3 The introduction of SS16/16 is not intended to change the effective size of buffer requirements from the two going-concern regimes, which operate in parallel, with firms expected to satisfy the criteria of both. In practice, this creates a 'usable' buffer, which is the amount of CET1 that a firm subject to both the risk-weighted capital and leverage regimes would currently be able to lose before breaching a minimum going-concern requirement. This concept is illustrated in Figure 1.¹

Figure 1 – the usable buffer



2.4 The PRA proposes to update SS16/16 to clarify its expectations regarding:

- the amount of CET1 that firms should not count simultaneously towards buffer requirements and MREL (ie an amount equal to the size of the usable buffer derived from the two going-concern regimes); and
- the consequences of not maintaining sufficient CET1 to meet both the usable buffer requirement and MREL.

¹ For simplicity it is assumed that the firm maintains only CET1 capital resources.

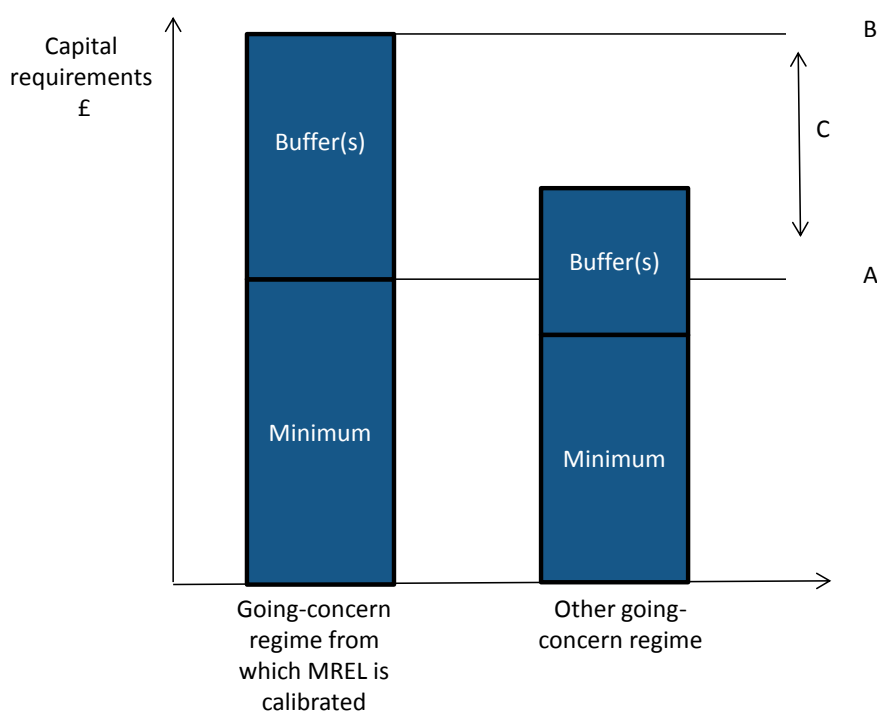
CET1 that should not count simultaneously towards buffers and MREL

2.5 For the majority of firms, the largest going-concern minimum requirement and the largest going-concern total capital requirement (minimum plus any applicable buffer(s)) will derive from one regime only. MREL would also be calibrated on the basis of the same going-concern regime.

2.6 In such cases, the PRA would expect that the amount of CET1 capital that firms should not count simultaneously towards buffers and MREL to be equal to the buffer requirement of the regime from which that MREL is calibrated.

2.7 The amount can be calculated as follows and is explained with reference to Figure 2. Comparing the total capital required between the risk-weighted capital and leverage regimes¹ (minimum plus any applicable buffer(s)), the larger of the two minima (A) is subtracted from the largest of the two total capital requirements (B). Firms are expected to maintain a buffer amount of CET1 equal to the resulting amount (C) that cannot also be counted towards their MREL requirement.

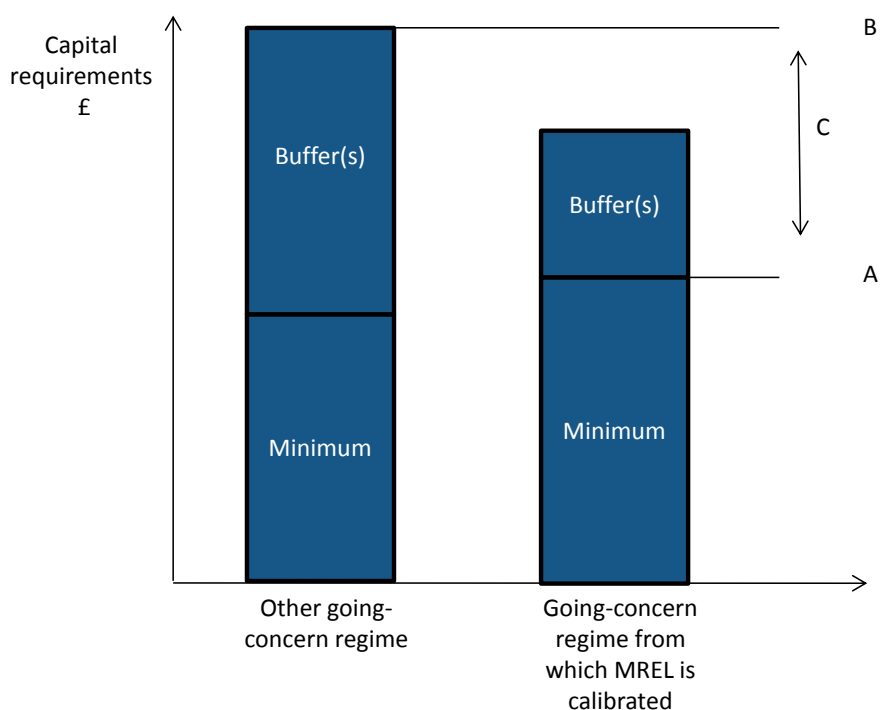
Figure 2 – the largest minimum and total capital requirements derive from one regime



2.8 In some cases, MREL will be calibrated on the basis of one capital regime (where that regime has the largest minimum requirement), but the largest requirement including buffers will derive from the other regime. Here, the PRA proposes that the amount of CET1 capital that firms should not count simultaneously towards buffers and MREL is that amount of CET1 that is usable when considering the requirements of the two going-concern regimes together (ie leverage and risk-weighted) – the usable buffer requirement.

2.9 The methodology in paragraph 2.7 applies. For clarity this situation is illustrated in Figure 3.

¹ Ascertained by comparing the risk-weighted asset and leverage requirements in sterling terms.

Figure 3 – the largest minimum and total capital requirements derive from different regimes

Consequences of not maintaining sufficient CET1 to meet both the usable buffer and MREL

2.10 The three regimes – risk-weighted capital, leverage and MREL – are enforced separately. Firms must therefore compare their own funds and eligible liabilities against each regime to which they are subject. The consequences of having insufficient own funds or eligible liabilities are different in each case.

2.11 The consequences of not meeting minimum risk-weighted capital requirements and the corresponding buffers are set out in CRD IV and implemented by the PRA's rules¹ and supervisory statements.² The consequences of not meeting the minimum leverage ratio requirement and the corresponding buffers are set out in SS45/15 'The UK leverage ratio framework',³ in line with the Financial Policy Committee's (FPC's) Direction and Recommendation to implement a UK leverage ratio framework.⁴

2.12 The PRA proposes that the consequences of a firm failing to maintain sufficient CET1 to meet the usable buffer requirement and MREL will be determined by the assumption that the firm has used the buffers of the going-concern regime where the total amount of capital required to meet both minimum and buffer requirements is largest.

2.13 This ensures consistency with the going-concern regimes, where a firm would first use the buffers of the regime under which the total amount of capital required to meet both minimum and buffer requirements is largest.

1 See the Capital Buffers Part of the PRA Rulebook.

2 See SS31/15 '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 SS6/14 'Implementing CRD IV: capital buffers', April 2014: www.bankofengland.co.uk/pr/Pages/publications/capitalbuffers.aspx.

3 December 2015: www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss4515.aspx.

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

MREL and risk-weighted capital buffers

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

2.15 The PRA proposes to adopt the policy set out, as amended, in the appendix to this CP. If a firm fails to maintain the amount of CET1 to meet the usable buffer requirement described in paragraphs 2.5 to 2.9 above, and the total amount of capital required to meet both minimum and buffer requirements of the risk-weighted capital regime is larger than those of the leverage regime, then the PRA proposes that the firm will be considered to have used the buffers of the risk-weighted capital regime.

2.16 As such, a firm that does not have, or expects that it will not have, sufficient CET1, in addition to any CET1 counted towards its MREL, to meet its CRD IV combined buffer and the PRA buffer would be expected to notify the PRA of this as soon as practicable, consistent with Rule 2.7 of the Fundamental Rules Part of the PRA Rulebook, explaining why this has happened or is expected to happen.

2.17 A firm which, as a result, is considered to have insufficient CET1 to meet its CRD IV combined buffer or PRA buffer in addition to any CET1 counted towards its MREL would expect enhanced supervisory action and be expected to prepare a capital restoration plan. If the PRA was not satisfied with the capital restoration plan, or with the firm's reasons for the shortfall, it would 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.

MREL and leverage ratio buffers

2.18 The PRA proposes to adopt the policy set out, as amended, in the appendix to this CP. If a firm fails to maintain the amount of CET1 to meet the usable buffer requirement described in paragraphs 2.5 to 2.9 above, and the total amount of capital required to meet both the minimum and buffer requirements of the leverage regime is larger than those of the risk-weighted capital regime, then the PRA proposes that the firm will be considered to have used the buffers of the leverage regime.

2.19 To achieve this outcome, the PRA proposes to invite firms subject to the leverage regime 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 described in paragraphs 2.5 to 2.9 above. 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 As set out in SS6/14 'Implementing CRD IV: capital buffers', April 2014, the combined buffer comprises the countercyclical capital buffer, the capital conservation buffer (CCoB), 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 The PRA's statutory obligations

3.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. The PRA meets these obligations by providing the following in its consultations:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective, insurance objective (if applicable), and secondary competition objective;
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles; and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.

3.2 The PRA is required by the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

3.3 The PRA must also have regard to the regulatory principles set out in FSMA.

3.4 The PRA should also have regard to aspects of the governments' economic policy as recommended by HM Treasury.¹

3.5 While the PRA is not proposing rules in this CP, it has considered the proposed supervisory statement with regard to its statutory obligations. These considerations are set out below.

Cost benefit analysis

3.6 The proposed amendments to SS16/16 clarify the PRA's policy with regard to a specific circumstance. Specifically, the situation where MREL is calibrated on the basis of one capital regime, but where the largest requirement for buffers exists in the other going-concern regime.

3.7 The amendments are not intended to have any impact beyond that which was intended in SS16/16. Readers should therefore refer to CP44/15 'The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions'² for a cost benefit analysis in relation to the policies.

Compatibility with the PRA's objectives

3.8 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, as a secondary objective, facilitate effective competition in the markets for services provided by PRA-authorized persons in carrying on regulated activities.³

¹ Section 30B of the Bank of England Act 1998.

² December 2015: www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp4415.aspx.

³ See sections 2B (1), 2B(2) and 2H of FSMA.

3.9 The PRA considers that making the clarifications proposed in the draft SS will advance its general objective by preserving the role of buffers in providing going-concern loss absorbency above minimum requirements.

3.10 With regard to the PRA's secondary objective, the amendments are not intended to have any impact beyond that which was intended in SS16/16. Readers should therefore refer to CP44/15.

Regulatory principles

3.11 In developing the proposals in this CP, the PRA has had regard to the regulatory principles as set out in FSMA. Two of the principles are of particular relevance.

3.12 The first is the principle that the PRA should exercise its functions as transparently as possible. The PRA judges that the proposals outlined in this CP bring greater clarity and transparency to the PRA's capital framework and fully align with this principle.

3.13 The second is the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction. The PRA has followed this principle when developing the proposals outlined in this CP. In particular, the PRA judges the benefits from expecting firms to preserve the role of buffers in providing going-concern loss absorbency above minimum requirements will outweigh any implementation burden or cost in doing so. However, the PRA welcomes views from respondents on this judgement.

HM Treasury recommendation letter

3.14 In March 2017, HM Treasury has made recommendations to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the objectives of the PRA and apply the regulatory principles set out in FSMA.¹

3.15 Although the HM Treasury recommendations were made after the publication of SS16/16, the PRA has considered these recommendations. The PRA views that SS16/16 is consistent with the Government's economic policy, particularly with regard to 'continuing to strengthen the financial system, improving the regulatory framework to reduce risks to the taxpayer and building resilience, so that it can provide finance and financial services to the real economy and realise better outcomes for consumers, supporting sustainable economic growth and encouraging productive investment'.

Impact on mutuals

3.16 With regard to the impact on mutuals, the amendments are not intended to have any impact beyond that which was intended in SS16/16. Readers should therefore refer to CP44/15.

Equality and diversity

3.1 With regard to the impact on equality and diversity, the amendments are not intended to have any impact beyond that which was intended in SS16/16. Readers should therefore refer to CP44/15.

¹ Information about the Prudential Regulation Committee and the recommendations from HM Treasury are available on the Bank's website at www.bankofengland.co.uk/about/Pages/people/prapeople.aspx.

Appendix - Draft amendments to Supervisory Statement 16/16 ‘The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions’

Underlining indicates new text and striking through indicates deleted text.

1 Introduction

...

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 and PRA SSs on risk-weighted capital buffers and leverage buffers.

2 Buffers

[To be inserted before paragraph 2.1]

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’¹ 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.² 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.

Risk-weighted capital buffers

...

~~[Deleted] 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.~~

2.2A 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 ~~the CET1 counted towards its MREL,~~ 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

¹ 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.

² 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.

used, or be about to use, the buffers of the regime where the total amount of capital required to meet its CRDIV combined buffer and the PRA buffer, it should notify the PRA of this as soon as practicable, consistent with Fundamental Rule 7, explaining why this has happened or is expected to happen. 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 7,¹ explaining why this has happened or is expected to happen. 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 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.²

...

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

2.7 The PRA expects firms not to meet ~~their leverage ratio buffers~~ 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 ~~its leverage ratio buffer(s).~~ 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.

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.

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 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.