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# Consolidation and Clarity: A Closer Look at the Bank of England’s Revised MREL Approach

October 2024

## Consultation: Amendments to the Bank of England’s approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

The Bank of England (the “**Bank**”), as resolution authority, has published a consultation paper (15 October 2024) (the “**CP**”) on amending its approach to setting a minimum requirement for own funds and eligible liabilities (“**MREL**”). The deadline for responses is 15 January 2025. The Bank anticipates finalising its response during the first half of 2025 with implementation to begin from 1 January 2026. HMT has published a statement welcoming the proposals. It states that it will engage with industry on changes to secondary legislation envisaged by the Bank.

The CP brings together proposals relating to the Bank’s statement of policy on its approach to setting a minimum requirement for own funds and eligible liabilities (the “**MREL SoP**”).

The proposals are grouped around three themes: (i) restating, with modifications, certain UK Capital Requirements Regulation (“**UK CRR**”) total loss-absorbing capacity (“**TLAC**”) provisions in the MREL SoP and other related changes; (ii) updates to the Bank’s indicative thresholds for setting a stabilisation power preferred resolution strategy; and (iii) revisions to reflect findings from the Resolvability Assessment Framework (“**RAF**”) and lessons from policy implementation.

The proposed changes to the Bank’s MREL SoP are set out in Annex 2 to the CP.

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## Restating UK CRR TLAC provisions and other related changes

As part of the wider post-Brexit reforms to financial services legislation in the UK, EU-derived legislation, including the UK CRR and the MREL UK Technical Standards, will be revoked and restated in the form of regulator policies.

For firms that are subject to MREL above their Minimum Capital Requirements ("**MCR**"), the Bank aims to consolidate, simplify, clarify and remove arbitrage between the existing two regimes consisting of onshored TLAC (which currently applies to UK G-SIBs) and the UK MREL SoP (which applies to all firms subject to MREL requirements). To achieve this, the Bank proposes to restate the MREL SoP with modifications.

### Eligibility criteria for Eligible Liabilities Instruments ("ELIs")

ELIs are non-own funds debt instruments that contribute to a firm's loss-absorbing capacity and recapitalisation in resolution. Currently, UK G-SIBs must follow additional eligibility criteria from the UK CRR on top of those applicable to MREL firms generally in, the MREL SoP and the Bank Recovery and Resolution (No. 2) Order 2024 (the "**BRR No. 2 Order**"). The Bank proposes consolidating these criteria within the MREL SoP, making them applicable to all MREL firms. The intention is to remove duplication, simplify the language and use clearer drafting, without significantly increasing the requirements on firms in practice.

Examples of proposed adaptations:

> **Set- off and netting arrangements**: The two sets of existing provisions will be combined into a more comprehensive rule.

> **Investor acceleration rights**: The prohibition of full investor acceleration rights in UK CRR will be extended to all MREL eligible liabilities. This proposal to extend it to all MREL firms should have little practical consequence as it reflects existing market practice.

> **Interaction between Tier 2 capital and MREL**: The Bank proposes to clarify that Tier 2 instruments with a residual maturity of at least one year qualify for MREL eligibility to the extent they no longer qualify as Tier 2 (due to having reached the final five years of their contractual tenor) and that once a Tier 2 instrument has a residual maturity of less than one year, it can still be reported as contributing to MREL resources but only to the extent of its daily amortising Tier 2 capital value.

Certain derogations from eligibility criteria for ELIs issued before 27 June 2019 will be restated.

## Key Takeaways

Included in the Bank's proposals:

> **Increased liability management flexibility**: UK-GSIBs will no longer require prior permission to redeem MREL, provided that the firm is not in breach of or will not breach its MREL or deplete its capital buffers

> **Clarification that Tier 2 capital with less than a year outstanding will still qualify** as MREL but only to the extent of its daily amortising Tier 2 capital value

> **Higher threshold before bail-in resolution strategy appropriate** reflecting nominal economic growth in the UK

> **Reduction in MREL for transfer resolution strategy firms**, such that MREL should equal MCR

> **Focus on removing duplication and simplification**. The CP does not propose material changes to the ELI criteria itself

> **Legal opinions and external legal advice essential**. The Bank reiterates that an external legal opinion is required for each MREL issuance

### Deductions from MREL eligible liabilities resources

Currently resolution entities of UK G-SIBs are required to deduct from eligible liabilities resources any holdings that they have of ELIs issued by other G-SIBs in order to manage contagion risk through the banking system. The Bank is proposing to extend this deduction requirement to all MREL firms. Aside from this expanded scope the UK CRR deductions eligible liabilities regime will remain broadly unchanged and will be consolidated in the MREL SoP.

Specific exemptions would apply for (i) firms or consolidated entities in the PRA's Small Domestic Deposit Taker regime and (ii) holdings by an intermediate entity of internal ELIs issued by a subsidiary.

The Bank considers that firms would have sufficient time to prepare for the revised regime as it is not proposed to come into force until January 2026. In addition, firms growing into MREL will be subject to deductions only after they meet end-state MREL.

### Redemptions and reductions of instruments: General Prior Permissions ("GPPs") no longer required

The Bank proposes to remove the need for UK G-SIBs to apply for prior permission to call, redeem, repay or repurchase ELIs. The current practice of G-SIBs obtaining annual GPPs would no longer need to be followed. UK G-SIBs will therefore be in the same position as other MREL firms which currently do not need a permission or approval from the Bank for a reduction as long as the firm is not at that time in breach of its MREL and the reduction itself would not cause a breach of its MREL. However, the Bank proposes to amend the MREL SoP to clarify that specific prior permission will still be required in cases where a firm would either breach its MREL or start to deplete its applicable capital buffers or if the firm is already in breach of its MREL or has started to deplete its applicable capital buffers.

This is likely to be seen as a welcome proposal by the market, reducing the regulatory burden and associated costs and providing firms with more flexibility to optimise its capital structure in a timely manner.

### Aligning contractual triggers and other expectations for internal non-CET 1 own funds instruments

The Bank proposes extending the requirement to include contractual triggers for write down and/or conversion powers in internal MREL eligible liabilities (as 'umbrella agreements') to internal AT1 and internal Tier 2 instruments (i.e. non-CET1 own funds instruments). This proposed change would apply to existing internal non-CET1 own funds instruments at the date of implementation of this policy change (expected to be January 2026) subject to a limited 'impracticability' exception in the case of non-UK material subsidiaries of UK-headquartered firms. To the extent that existing internal non-CET1 own fund instruments do not already contain such triggers, the Bank expects firms to undertake an exercise ahead of implementation of the updated MREL SoP to update such instruments. Some issuers may need to consider the accounting consequences for them of introducing such trigger.

### Other expectations in relation to AT1 and Tier 2 and instruments

Further, the Bank proposes to amend the MREL SoP so that where it is not possible to write down and/or convert non-CET1 own funds instruments to CET1 using statutory powers, the Bank could determine that it needs to use its powers under section 3A of the Banking Act to direct relevant persons to address impediments to resolution. This could be relevant in the case of an instrument governed by non-UK law where there is no statutory or contractual recognition of UK bail-in rules.

## Updates to the Banks indicative thresholds for setting a stabilisation power preferred resolution strategy

The Bank determines a preferred resolution strategy for each firm it regulates. Either a (i) modified insolvency, (ii) transfer or (iii) bail-in resolution strategy is selected reflecting the scale and potential impact of a firm's failure. A firm's MREL is then determined by the Bank in line with the preferred resolution strategy. MREL above MCR is only relevant to firms subject to a transfer or bail-in strategy.

For larger firms with total assets of (currently) £15 billion - £25 billion, a bail-in resolution strategy is generally determined by the Bank to be appropriate. For medium sized or smaller firms, the transfer or modified insolvency resolution strategy is generally likely to be determined to be more appropriate. Under the current rules, firms with more than 40,000 – 80,000 transactional accounts are generally expected to fall within a transfer resolution strategy provided their total assets are less than the £15 billion threshold.

### Indicative total assets threshold

The Bank is consulting on an increase to the indicative total assets threshold (which is used to determine if a bail-in preferred resolution strategy is appropriate) to £20 billion - £30 billion total assets (from £15 billion - £25 billion). The Bank notes this is mostly to reflect nominal economic growth in the UK and that it intends to keep this threshold under review, although it does not expect to update it frequently.

The Bank says it does not anticipate the increase in threshold would result in immediate changes to the preferred resolution strategy of particular firms. Instead, the increased threshold would provide growing firms subject to one of the other preferred resolution strategies, space to grow before being potentially set a bail-in preferred resolution strategy.

### Indicative transactional accounts threshold

The Bank proposes to retain the indicative threshold relating to the number of transactional accounts at 40,000 – 80,000 as one of a number of factors taken into account in determining the appropriate resolution strategy for a firm. This indicative threshold currently applies to transfer strategies.

### MREL for transfer preferred resolution strategy firms

Currently, firms with a transfer preferred resolution strategy are required to hold MREL equivalent to twice the MCR, although the Bank notes there are cases where a firm's MREL has been reduced to a level closer to the MCR.

The CP proposes a reduction in MREL, such that for these firms their MREL would likely be equal to their MCR just as is the case currently with modified insolvency preferred strategy firms. This is consistent with similar proposals in the EU to reduce MREL requirements for institutions/groups with a transfer strategy.

The proposed change is subject to the passing of the Bank Resolution (Recapitalisation) Bill which was introduced in Parliament in July 2024. This bill, if passed, would provide the Bank with enhanced flexibility to manage the failure of a smaller firm, which include the possibility of using funds provided by the banking sector and is considered by the Bank as key to supporting this proposed a reduction.

In practice, this proposal is likely to have only a limited impact in the short term for firms that are already subject to MREL above MCR (as there are only two firms currently that fall within the transfer preferred resolution strategy category). However, it may help to facilitate M&A activity in the challenger bank sector where an incremental MREL add-on would otherwise have been expected to apply.

No amendments are proposed in respect of setting MREL for firms with a bail-in preferred resolution strategy.

For reference the Bank's current determination for firms' MREL's is here.

## Revisions to reflect findings from the Resolvability Assessment Framework ("RAF") and lessons from policy implementation

Finally, the Bank includes revisions to the MREL SoP to reflect findings from its most recent RAF of major UK banks (6 August 2024), and other lessons from policy implementation. These proposals are intended to provide additional clarity and flexibility relating to:

- the appropriate basis for measuring MREL eligible liabilities;
- transitional arrangements for growing firms; and
- assurance and information relation to MREL.

### Appropriate basis for measuring MREL eligible liabilities

The Bank proposes to clarify that the full accounting value of an ELI (i.e. including accrued interest and fair value hedge adjustments, if applicable) should be used as the basis for measuring the value that can be used to meet a firm's MREL. This is because, broadly, the Bank considers the full accounting value of the ELI to reflect the amount that would be available to absorb, and recapitalise for, potential losses in the event of write-down or conversion to equity.

This is aligned with the findings of the EBA monitoring report (27 June 2024) and the EBA is expected to consult in the near term on reporting and disclosure for TLAC instruments to complement the nominal value with the carrying value of the instruments.

This clarification is intended to promote consistent practice in the industry, however the Bank acknowledges this change may result in greater volatility in MREL ratios over time. With a view to avoiding any unintended consequences for firms' funding arrangements, the Bank welcomes feedback on the proposals.

### Transitional arrangements in an M&A scenario

For firms transitioning organically towards meeting MREL above its MCR there is an existing stepped glide-path of six years (plus potentially two further years) to meet end-state MREL.

In recognition that in a merger or acquisition there may be a period where the combined entity may not immediately be able to comply with enhanced MREL (e.g. externally issued liabilities that would otherwise be eligible as MREL may be ineligible due to no longer being issued by the group's resolution entity following its acquisition), the Bank proposes to clarify in the MREL SoP that it can make a case-specific judgement and apply 'transitional' MRELs or other adjustments. This is a welcome reservation of flexibility as some recent UK M&A and restructuring situations demonstrate However, the Bank notes that any such inability to meet the required MREL should persist for as short a time as practicable and firms should consider all actions available to remedy them, including liability management exercises.

### Legal opinions and External Advice

The Bank takes the opportunity in the CP to reiterate the current MREL SoP rules regarding the need for independent legal advice and legal opinions in respect of an ELI's eligibility as MREL, as well as the importance of firms having effective and documented internal processes.

In relation to legal opinions, the Bank confirms that:

- Entities in scope of MREL above MCR should obtain external, independent legal advice (in-house counsel is not considered 'independent') on each liability's eligibility to be included in a firm's MREL. The advice would normally be expected to take the form of a legal opinion which discusses each of the applicable eligibility criteria in turn, with reference to the terms of the specific issuance in question.
- The advice cannot be generic, such as a non-issuance specific guide or checklist or the advice given in relation to a Medium Term Note Programme (as opposed to a specific

issuance under the programme). Practice in this area currently varies among firms.

- The opinion is expected to be instrument-specific for both external and any internal ELIs.
- For non-UK law governed instruments, an additional legal opinion is expected to be obtained to confirm that the Bank's decision to convert or write down the ELI would be effective under the principal governing law of the relevant instrument.

Under the revised SoP, this policy would continue to apply both to external and internal MREL eligible liabilities and legal opinions should continue to be provided to the Bank upon request, without which the Bank may not be able to verify eligibility.

## Timing

The deadline for responding to the CP is 15 January 2025.

The Bank anticipates finalising its response during the first half of 2025 with implementation to begin from 1 January 2026.

For any further information or commentary on the CP, please contact one of your usual Linklaters contacts

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