BREXIT FREEDOM AND THE LESSONS OF SVB: THE BANK OF ENGLAND'S MREL CONSULTATION

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(6 min read)

The Bank of England (BoE) is consulting on amendments to its approach to setting the minimum requirement for own funds and eligible liabilities (MREL). The proposals are designed to ensure that the UK's MREL framework is simplified and consolidated where possible, to make it easier to navigate and implement and keeps up to date with, and is responsive to, wider developments in financial regulation and markets. This looks to both streamline the requirements for MREL-eligible instruments and increase the threshold at which a firm subject to a bail-in strategy needs MREL from £15bn to £20bn in total assets. This will align the threshold with the Prudential Regulation Authority's (PRA) regime for small domestic deposit takers (SDDTs), which must have less than £20bn total assets (among other criteria).

EXECUTIVE SUMMARY

On 15 October 2024 the BoE published a consultation paper on proposed amendments to its approach to setting the MREL. In parallel, HM Treasury published a draft chapter of the Special Resolution Regime Code of Practice which covers the recapitalisation mechanism introduced in the Bank Resolution (Recapitalisation) Bill.

The BoE and HMT proposals consolidate and simplify current MREL processes, reflect the Government's wider project of moving EU-derived UK law into regulatory rules, and build on the lessons of the SVB resolution in 2023. They will be of interest to all firms:

For GSIBs the BoE is proposing:

- to transfer the "TLAC" provisions currently in the UK CRR to the BoE's MREL statement of policy (SoP). HMT will repeal the UK TLAC provisions;
- to make the inclusion of contractual write-down and conversion triggers, exercisable by the Bank, mandatory in internal AT1 and T2. These are not currently fully mandatory, though are required for internal MREL that is not AT1 or T2;
- to clarify the need for a relevant external legal opinion on all internal and external MREL- eligible instruments;
- to remove the current blanket requirement on GSIBs to obtain the consent of the BoE prior to the redemption or repurchase of MREL-eligible instruments. GSIBs will be subject to the same requirements as other firms, which only require consent where the redemption would breach MRELs or deplete capital buffers; and
- to confirm that the accounting value, rather than the nominal value, should be used to calculate the value of an instrument for meeting MRELs.

For other firms with a bail-in or transfer preferred resolution strategy, the points applicable to GSIBs above will apply and in addition:

- firms subject to a transfer preferred resolution strategy will have their MREL reduced from 2 x minimum capital to their minimum capital requirements, providing the Bank Resolution (Recapitalisation) Bill becomes law;
- the BoE proposes to incorporate some of the eligibility criteria for MREL-eligible instruments that currently only apply to GSIBs to all firms. Firms will need to consider their stock of internal and external MREL-eligible instruments against the new criteria;
- the BoE may provide a "transitional" MREL or make other adjustments in the context of the M&A activities to address issues relating to meeting MREL for the post-transaction combined group; and
- the MREL deductions regime currently applicable only to GSIBs will also apply to all firms (subject to some limited exceptions).

EXECUTIVE SUMMARY CONT.

For firms below the current £15bn indicative total assets threshold for a bail-in strategy

- The BoE is proposing to increase the indicative threshold to £20bn-£30bn. The transactional account threshold remains unchanged at 40,000 to 80,000.
- The BoE and HMT have clarified that the new Financial Services and Compensation Scheme (FSCS) recapitalisation mechanism currently going through Parliament would operate as a backstop tool if needed at the point of a firm's failure. There is no suggestion the BoE will include additional up-front resolvability requirements on firms on whom the new mechanism may be used if they failed but which do not currently have a bail-in or transfer preferred resolution strategy. As noted above, the BoE intends to lower MREL for firms with a transfer preferred resolution strategy in reliance on the new mechanism.

The BoE proposes the changes come into force on 1 January 2026, other than the requirement for legal opinions and other assurance requirements, which will come in soon after the policy is finalised, but not before July 2025. In relation to the changes to the eligibility criteria, the BoE does not appear to be grandfathering any existing instruments. Whilst the BoE states that it does not think the changes will significantly increase the burden on firms in practice, firms will need to consider their existing stock of MREL-eligible instruments against the new requirements and assess the need for any changes.

The deadline for responses to the consultation is 15 January 2025.

WHAT ARE THE MAIN CHANGES?

Changes to MREL thresholds

- The BoE is proposing to increase the indicative total assets thresholds at which it will consider if a firm should have a bail-in preferred resolution strategy from £15 billion–£25 billion to £20 billion–£30 billion. The BoE notes this reflects nominal economic growth, but it also aligns the MREL thresholds with the top end of the threshold for the PRA's SDDT regime at £20bn total assets.
- The indicative threshold for a transfer preferred resolution strategy remains 40,000 to 80,000 transactional accounts. However, provided the Bank Resolution (Recapitalisation) Bill becomes law firms with a transfer strategy will see their MRELs reduce from twice minimum capital to minimum capital, in reliance on the new mechanism in the Bill.

Changes to the MREL eligibility criteria

Currently the eligibility criteria for non-own funds MREL-eligible instruments sits across the Banking Act 2009, the BRRD No.2 Order and the Bank's MREL SoP, with an additional overlay of more prescriptive requirements which apply only to GSIBs under the UK CRR TLAC provisions. As part of the general process of repealing the UK CRR and moving the provisions into regulatory rules, the BoE is proposing to consolidate the CRR TLAC provisions into the SoP, so that the same set of requirements apply to all firms.

The key proposed changes include:

i. External MREL (MREL-eligible liabilities issued to third parties outside the banking group) -

1. GSIBs: should already comply with the new requirements as a result of their compliance with the CRR TLAC provisions.
2. For non-GSIBs: the new rules include provisions relating to redemptions, set-off or netting arrangements, and investor acceleration rights which in places go beyond the current SoP.

ii. Internal MREL - (MREL-eligible liabilities issued between entities within a banking group)

1. For all firms: the BoE proposes to make the inclusion of contractual triggers mandatory in internal AT1 and T2. Contractual triggers allow the BoE to contractually write down and/or convert the instrument to CET1 on the failure of the firm without the use of the BoE's statutory powers. They are already required for internal MREL-eligible liabilities that are not AT1 or T2. The BoE notes this requirement was not included before due to a possible conflict with the then directly applicable EU CRR. The BoE is now proposing to take advantage of the flexibility afforded by the UK's exit from the EU.

WHAT ARE THE MAIN CHANGES?

Assurance requirements - the need for an external legal opinion on each MREL instrument

The BoE proposes to confirm that it requires firms to:

- have effective and documented processes to ensure they are able to meet their MREL at all times; and
- obtain an external legal opinion in the relevant jurisdiction on each internal or external MREL-eligible instrument. However, the BoE is not proposing to bring in a process analogous to the PRA's "pre issuance notification" process.

MREL deductions, redemptions and valuations

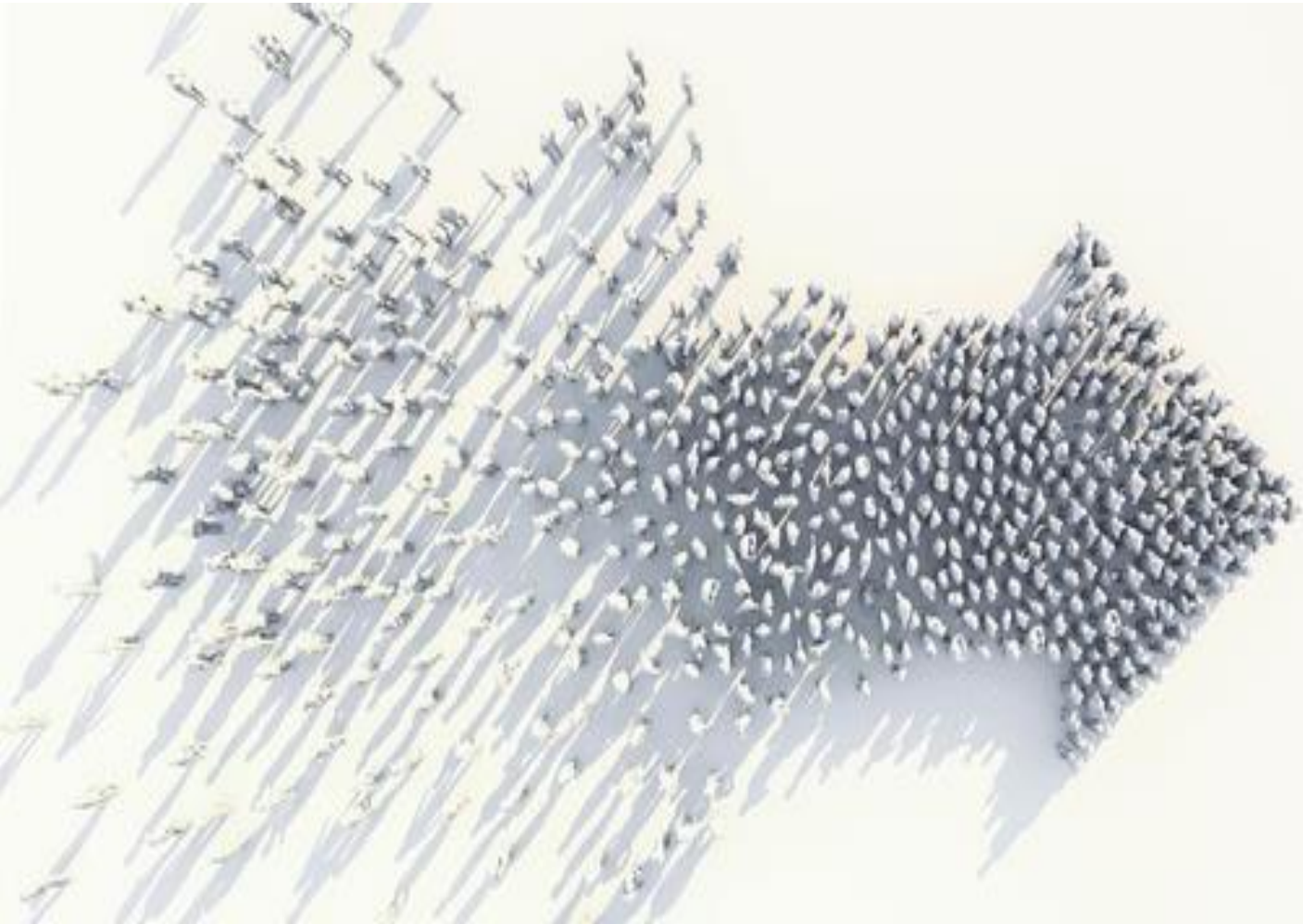
- **Deductions:** The BoE proposes to apply the current CRR TLAC deductions regime to all firms. For non-GSIBs, the key change will be that holdings of MREL-eligible instruments issued by GSIBs must be deducted from the firm's MREL resources. This will not apply to SDDT firms. There is also an adjustment for firms with a multiple point of entry (MPE) strategy.
- **Redemptions:** The BoE proposes to remove the current blanket requirement on GSIBs to obtain the consent of the BOE prior to a redemption or repurchase of an MREL-eligible instrument. In future, GSIBs will be subject to the same requirements as other firms, which only require consent where the redemption would breach MREL or deplete capital buffers.
- **Valuations:** The BoE is proposing to confirm that the accounting value, rather than the nominal value, should be used to calculate the value of an instrument for meeting MREL.

Bank Resolution (Recapitalisation) Bill

- The Bill, introduced on 18 July 2024, establishes a new mechanism to support small bank resolution where that is in the public interest. The proposals, which are part of lessons from the resolution of SVB UK in 2023, would allow the BoE to use funds provided by the FSCS to cover certain costs associated with resolution. These would be subsequently recouped by a levy on the industry.
- The SOP, and a draft addition to HMT's Code of Practice on the resolution regime published at the same time, sets out further thinking about how the mechanism may be used in practice.
- Both the BoE and HMT present the new mechanism as a backstop where additional loss-absorbing capacity is required beyond a firm's own resources. It is not anticipated to feed into the MRELs for firms with a bail-in preferred resolution strategy. However, as noted above, in reliance on the mechanism the BoE is reducing MRELs for forms with a transfer preferred resolution strategy.
- Smaller firms should note that the BoE is not proposing to place additional resolvability requirements on firms which might be in scope of the new mechanism on failure, but which do not have a transfer preferred resolution strategy. However, this does raise the question of whether the new mechanism could be effectively used on such firms.

NEXT STEPS

If you want to find out what this means for your business, please feel free to get in touch with our Financial Markets team who would be delighted to speak to you.



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