afme/ Finance for Europe

11 March 2016

Mr Benjamin King
Resolution Directorate
Bank of England
Threadneedle Street
London
EC2R 8AH

By post and email to MRELfeedback@bankofengland.co.uk

AFME response to the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

Dear Mr King,

Please find enclosed the Association for Financial Markets in Europe's response to the Bank of England consultation paper on its approach to setting a minimum requirement for own funds and eligible liabilities (MREL).

Please do not hesitate to contact us if you have any questions or wish to discuss these issues further.

Yours sincerely

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Consultation response

The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

11 March 2016

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity to comment on the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL).

Executive summary

AFME supports the implementation of MREL as part of putting in place effective resolution plans and addressing "too-big-to-fail". We strongly support the efforts by the authorities to put in place credible and effective resolution plans that enable banks to be resolved without systemic disruption or exposing taxpayers to loss. MREL requirements play an important role in achieving this. We welcome the Bank of England's consultation on its approach to setting MREL and its proposed statement of policy, namely to implement MREL in a way which is consistent with the Financial Stability Board's (FSB) Principles and Term Sheet on Total Loss-absorbing Capacity (TLAC)[2].

We are broadly supportive of the Bank of England's proposed approach to the implementation of MREL as set out in the consultation paper. We welcome the attempt by the Bank of England to provide greater clarity in this important area. Clarity is essential to enable banks to establish implementation plans to meet the requirements as well as for investors in banks and MREL instruments.

In particular we support the proposals to apply a transitional period during which MREL requirements are set consistent with capital requirements in order to provide banks with time to meet requirements, to implement TLAC requirements through MREL to avoid GSIBs having to meet two conflicting and potentially additive requirements with the same purpose and for the requirements to be tailored to the preferred resolution strategy for the global group.

There are however a number of important areas where we have recommendations and/or believe that further clarity is required, including:

[1]AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

[2] FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution, Total Loss-absorbing Capacity (TLAC) Term Sheet, 9 November 2015 (TLAC Term Sheet)

- the interaction of capital buffers with MREL. While we acknowledge the desirability of capital buffers being capable of utilisation without a breach of MREL, consistent with the FSB TLAC principles, it is unclear how this approach interacts with maximum distributable amounts (MDA) restrictions under CRDIV. We believe that this merits further consideration as we do not believe that MDA restrictions should be automatically triggered by virtue of a bank breaching its combined buffer solely as a result of CET1 being used to meet a temporary shortfall in MREL;

- permitting existing capital issued by subsidiaries of resolution entities to be included towards the external TLAC of the resolution entity until 1 January 2022, as provided for in the TLAC Term Sheet. However it remains unclear as to how this interacts with CRDIV which permits minority interests to be included in group capital resources (subject to limits);

- the scope of application of requirements on a resolution group basis rather than a consolidated basis. This is particularly pertinent for groups with non-dependent entities which are likely to be subject to a multiple point of entry (MPE) resolution strategy with more than one resolution entity. Therefore a consolidated requirement would be inappropriate but rather an overall group requirement should be an aggregation of locally applicable MREL/TLAC requirements imposed on each resolution group with no further group level 'adjustment';

- clarity as to the methodology for determining post-resolution capital requirements (including Pillar 2) for the purposes of the recapitalization amount following, for example, recovery options and balance sheet depletion;;

- the treatment of non-bank and non-material entities within the group in the context of consolidated and internal MREL requirements;

- the approach to liabilities which rank *pari passu* with MREL, where we propose that the Bank of England should apply the ability under the TLAC Term Sheet for excluded liabilities of up to 5% of the resolution entity's eligible external TLAC to be permitted and for the Bank to consider any excluded liabilities in excess of this in accordance with article 3 of the draft Regulatory Technical Standards;

- the approach to the scope, calibration and characteristics of internal MREL, where while acknowledging that this is an area of policy still under development, we would welcome confirmation of the Bank's intention to align requirements with the FSB TLAC principles and Term Sheet and further work on internal TLAC. In particular we believe that the Bank of England should expressly adopt the concepts of material sub-groups and the calibration range of 75-90% for internal MREL in its statement of policy and consider an approach that would not require 100% of internal MREL to be pre-positioned on the balance sheet of the relevant subsidiary; and

- we believe that while the consultation paper states that "the proposed Statement of Policy should be read in light of the wider international context, the need to facilitate cross-border resolutions, and in some cases a statutory requirement to reach joint decisions", this could usefully be explained in the Statement of Policy itself. This would provide greater clarity for stakeholders that might not have read the consultation paper.

We discuss these and further comments in greater detail below.

Transitional arrangements

We welcome the Bank of England's proposed transitional period and the general approach of setting MREL consistent with capital requirements until 1 January 2019 for UK GSIBs and 1 January 2020 for other banks (including non-UK GSIBs). Whilst the TLAC implementation timeframe remains challenging, it is important that implementation is no earlier than that set out in the finalised FSB principles, and that national implementation does not introduce accelerated timelines.

In many cases implementation will require significant changes to the liability structures of banking groups and therefore an appropriate transitional period is essential. A significant transitional period is also necessary to avoid too great an impact on the market which could arise if a number of banks were forced to issue significant volumes in a short period, particularly given the BCBS' proposed approach to TLAC cross-holdings deductions and the likely limited investor base against the background of volatile market conditions. It is also important that banks have flexibility to develop implementation plans to transition to meet requirements at the end of the transitional period and we support the proposal not to set increasing MREL requirements during the transitional period.

While the proposed statement of policy provides welcome clarity in a number of areas, significant uncertainty will remain for banks and potential investors, including in relation to the overall quantum of MREL that will be required, internal MREL requirements and the need for agreement between resolution authorities in resolution colleges and Crisis Management Groups. It will therefore still be some time before banks have clarity on the overall requirements that they will be required to meet.

While we assume that it is implicit in the Bank of England's proposed approach, we would welcome confirmation in the Bank of England's final statement of policy that for GSIBs, the Bank will apply the phase-in of TLAC requirements in accordance with the TLAC Term Sheet (i.e. 16% RWAs and 6% leverage from 1 January 2019 and 18% RWAs and 6.75% leverage from 1 January 2022).

As part of the transitional arrangements, the Bank of England should adopt the approach anticipated in the TLAC Term Sheet of permitting existing capital issued by subsidiaries of resolution entities to be included towards the external TLAC of the resolution entity until 1 January 2022, in order to assist with implementation. In light of banks' existing structures and the proposed structural subordination requirements, and MREL requirements only being communicated to firms towards the end of 2016, failure to adopt this approach would require a substantial volume of new issuance from holding companies in a compressed period during 2017 and 2018.

We therefore believe that it is crucial that capital issued by subsidiaries of resolution entities is included towards external MREL of resolution entities until 1 January 2022 to allow for banks to complete the transition to relocate loss absorbing capacity at holding companies. This is particularly the case in light of the likely uncertainty regarding final requirements for internal MREL, disclosure requirements, cross-holdings treatment, and current market conditions which make new issuance challenging. It is however unclear how this interacts with CRDIV provisions which explicitly permits minority interests to be included in group resources (subject to limits).

As part of this, we fully support the use of a transitional MREL which the Bank may set after the end of the initial transitional period for banks undergoing structural change. This is particularly critical for banks undergoing significant structural changes to introduce intermediate holding companies and/or moving issuance of MREL including existing regulatory capital, to the designated resolution entity/entities.

Transitional arrangements are also important in relation to internal MREL. As acknowledged in the consultation paper, further details in relation to the requirements and characteristics of internal MREL are still to be determined. Internal MREL requirements also require agreement between home and host authorities. It is therefore unclear when banks will have clarity as to final internal MREL requirements and an additional phase of the transitional period might be appropriate for internal MREL to be put in place. While the arrangements themselves are intra-group, banks need clarity on the likely internal MREL requirements before they are able to plan their external issuances and investors in external MREL are likely to want to understand how internal MREL arrangements are likely to work before investing.

The Bank of England should encourage resolution authorities in other Member States to take a similar approach to the transitional period, to increase consistency and clarity across the European Union. It is also important to understand the extent to which the Bank expects the UK implementation to interact with non-EEA jurisdictions' local implementation of TLAC or lack thereof, particularly the US implementation which as proposed does not align with the FSB approach. This is a particularly pertinent issue for banks subject to an MPE strategy where local implementation will determine the overall group requirement.

Implementation of TLAC/incorporation of TLAC principles

We support the Bank of England's proposal to implement TLAC requirements for GSIBs through the application of MREL to avoid GSIBs having to monitor and comply with two different requirements which serve the same purpose. This avoids having two sets of conflicting and potentially additive sets of requirements. A single requirement would also be clearer for investors. Implementation of the TLAC standard should also assist with ensuring consistency across jurisdictions and facilitate cross-border cooperation.

As discussed further below, we consider that the Bank of England should confirm how MREL will be applied to banks subject to an MPE strategy, specifically the need to apply MREL on a resolution group basis and not on a consolidated group basis. Furthermore, the Bank should align its approach to the scope of entities subject to internal MREL with the scope of internal TLAC under the TLAC Term Sheet, by adopting the concept of material sub-groups.

We encourage the Bank of England, together with other authorities, to ensure that any EU legislative proposal to implement TLAC does not take a materially different approach from that agreed within the FSB. The European Union should implement the TLAC principles and Term Sheet and should not depart materially from the international standard. It is important that regulatory capital and MREL that is not in the form of regulatory capital should continue to be regarded as separate classes of instruments reflective of the existing creditor hierarchy. Any deviation from this would undermine both the Basel III capital regime and the FSB TLAC principles. This is essential to provide international consistency, support cross-border cooperation and provide clarity for banks and the market.

Determination of the appropriate resolution strategy

We welcome the additional clarity provided on the Bank of England's approach to the determination of the appropriate resolution strategy for different banking groups. However, we note that the indicative thresholds between the types of resolution strategy are not aligned with the thresholds that the Bank of England has proposed in relation to other elements of the capital framework, such as the ring-fencing requirements, leverage ratio and systemic risk buffer, each of which seek to establish thresholds with a similar rationale. Using different definitions of deposit or introducing new definitions could also increase the cost of regulation by requiring reporting for each definition. Therefore to the extent possible the Bank of England should apply consistent thresholds based on existing definitions.

It is important that the market understands the implications of resolution strategies and has clarity on the likely order in which counterparties may be exposed to losses in the event of a resolution of the group. Resolution authorities have an important role to play in fostering understanding of resolution and resolution strategies, including understanding of how losses would be allocated. In particular we encourage the Bank of England and other authorities to explain to credit ratings agencies and investors the impact of resolution strategies and structural subordination on creditors of subsidiaries of resolution entities. As well as providing necessary clarity to stakeholders, this understanding is also necessary to ensure that investors in banks appropriately price risk, enhancing market discipline. This will also affect banks' cost of funding which ultimately influences the price of banking services to end users.

Calibration framework

We strongly support the Bank of England's confirmation that they will set MREL in accordance with the preferred resolution strategy for the group. We agree with the approach of tailoring MREL requirements to the relevant resolution strategy and the focus on facilitating that strategy, rather than, for example, starting from a requirement that is solely based upon the minimum amount of losses that would have to be absorbed before resolution funds could be used to absorb losses. We agree that the focus should be on resolvability and achieving the resolution objectives without the need to use resolution funds to absorb losses.

As discussed above, we also support the implementation of TLAC through MREL to avoid GSIBs having to comply with two separate requirements with the same purpose and to foster international consistency and cooperation.

As part of this it is necessary for the Bank of England to explicitly confirm that MREL will be applied on the basis of resolution groups, as consistent with the FSB Term Sheet. Specifically it is inappropriate for requirements to be imposed on a consolidated basis for groups which will have more than one resolution group and subject to an MPE resolution strategy. Not only does this contradict the TLAC principles, but it cannot be reconciled with the Bank's explicit recognition that groups may have multiple resolution entities. This contrasts with a bank subject to a single point of entry (SPE) resolution strategy where subsidiaries are often dependent and, where the application of MREL on the basis of resolution group would mean that MREL is imposed on a group consolidated basis, since by its nature, SPE necessarily means that there is only one resolution group within the consolidated group.

The overall 'group' MREL requirement for a banking group subject to an MPE resolution strategy should therefore be based on an aggregation of locally applicable requirements for each resolution group. This should be calibrated using local RWAs, inclusive of any exposures to group entities in other resolution groups. This approach would provide full alignment with the TLAC Term Sheet and ensure that MREL is applied in accordance with banks' individual resolution strategies.

Additionally, the proposed statement of policy does not address the question of whether MREL requirements will be expressed as a percentage of total liabilities and own funds, or RWAs and leverage. If requirements are to be expressed as a percentage of total liabilities and own funds, the mechanism for converting requirements based on RWAs and leverage into this percentage should be clarified. In particular it should be confirmed how the ratio for conversion would be determined as it is likely that RWA density would be different between firms, between entities within a group and also change over time as banks adapt their business models.

Calibration: loss absorption amount and interaction with regulatory capital buffers

While we agree that it makes sense for capital buffers to "sit on top" of MREL requirements to enable buffers to be utilised without involving a breach of MREL requirements in accordance with the TLAC principles[3], it is unclear how this would interact with the calculation of automatic restrictions on distributions as required under CRDIV for maximum distributable amounts (MDA). The impact of this interaction should be assessed. Our comments are elaborated upon in our response to the PRA's consultation on the interaction of MREL with capital buffers. In summary, while we support the view that CET1 should not be double-counted and that a breach of MREL should be treated seriously, in our view it would be inappropriate for MDA restrictions to be automatically imposed by virtue of a bank breaching its combined buffer solely as a result of CET1 being used to meet a temporary MREL shortfall. This could occur, for example, due to a temporary debt refinancing issue rather than the bank facing any immediate solvency issues and would result in a substantially higher threshold at which MDA could apply. We believe that these issues merit further consideration and we would welcome further discussion with the Bank of England and PRA. Clarification is required in particular due to the sensitivity of investors in Additional Tier 1 and subordinated debt, as well as credit rating agencies, to this issue.

We understand that the Single Resolution Board is considering taking a different approach to MREL implementation that would include capital buffers. We encourage the Bank of England and the PRA to raise the interaction of MREL with capital buffers with the Commission and the EBA in the context of their review of MREL under paragraphs 18 to 20 of article 45 of the BRRD to ensure that a consistent approach is taken across the European Union. A consistent approach is also necessary to facilitate joint decision making in the resolution colleges.

[3] Principle ix, TLAC Term Sheet

Furthermore, we agree with the Bank's proposal to exclude capital buffer requirements from the recapitalisation amount when setting MREL, which should also be explicitly clear in the final statement of policy.

Calibration: recapitalisation amount

We support the proposed approach of calibrating the recapitalisation amount based upon the resolution strategy for the firm. It is important that MREL for each group is set with the purpose of facilitating the relevant preferred resolution strategy.

As discussed above, consolidated MREL requirements should be an aggregation of the locally applicable requirements set for each resolution entity. Furthermore, as discussed further below, it is necessary for the recapitalisation amount to reflect the fact that not all group entities will need MREL. Specifically, non-banking or non-financial entities such as ancillary services providers or smaller investment firms, could potentially be put into a normal or modified insolvency process. Furthermore, in the case of subsidiaries which are not wholly owned, the banking group is unlikely to have the responsibility for recapitalisation of these entities given its lack of control, therefore MREL will not be needed. As a result, the application of the resolution strategy to these individual entities should be taken into account, with the RWAs and exposures arising from these entities to be excluded from any MREL calibration.

Further clarity should be provided as to how the Bank of England proposes to apply MREL requirements in relation to non-bank entities within a banking group, for example insurance companies and asset managers. Such entities should not contribute to the consolidated MREL requirement for the group as a whole.

We support the proposal to make adjustments to the recapitalisation amount to reflect expected changes in capital (including Pillar 2A) requirements for the firm following the resolution. These changes should be assessed as part of the resolution planning process and in discussion with the PRA regarding the likely requirements for the recapitalised entity. This approach should be supported by transparency from the PRA as to the framework that it will apply for determining the post-resolution capital requirements for a bank, for example how Pillar 2A requirements will change and which elements of these are likely to still be applicable to banks following resolution.

It is our strong view that the recapitalisation amount should take into account the inherent assumption that banks would have no equity remaining at the point of resolution, which even if additional losses have to be taken during resolution, remains a highly conservative starting point. The recapitalisation amount should also reflect the likely depletion of the size of the balance sheet that is likely to occur in the lead up to resolution. Losses suffered in advance of resolution would deplete the value of the assets of the entity, reducing its RWAs and leverage exposure. The implementation of recovery measures is also likely to reduce the size of the balance sheet ahead of resolution, for example through disposals. Accordingly the size of the bank to be recapitalised at the point of resolution is likely to be smaller and this should be considered when calibrating an appropriate recapitalisation amount.

We also support the acknowledgment that an institution emerging from resolution will not necessarily be required to immediately meet all capital buffer requirements and the proposal that the recapitalisation amount will not generally include any amount related to the institution's capital buffers. This is consistent with the purpose of buffers and reflects the fact that the institution has been through a resolution.

We support the proposed approach to the need to restore market confidence in the firm and agree with the statement that "in general it will be unnecessary to require an additional amount for market confidence, on the basis that a resolved institution should meet minimum regulatory capital requirements, remains authorised and its assets will have been significantly "cleaned up" following the recognition of losses through the fair, prudent and realistic valuation required in resolution". Maintaining market confidence in the group following the recapitalisation will also be supported by the authorities reinforcing market confidence through statements to the market and confirmation of access to central bank liquidity support.[4] It should however be expressly confirmed that the need to maintain market confidence will not result in any requirement for capital buffers to be recapitalised.

We support the proposal to allow an institution time to replenish its MREL and meet its ongoing MREL requirements following the application of the stabilisation powers. We suggest that the Bank of England should implement the paragraph 21 of the TLAC Term Sheet which provides for a 24 month period to rebuild TLAC following resolution.

Internal MREL

We strongly support the focus of MREL determinations being to facilitate the preferred resolution strategy for the group. We support the application of the TLAC principles for requirements for "external MREL" and "internal MREL" and believe that the TLAC Term Sheet should form the basis for the Bank of England's (and other resolution authorities') application of MREL within groups. The Bank of England has a particularly important role in setting a precedent for other jurisdictions in this area, given its position as a major home and host resolution authority.

We understand that internal TLAC/MREL is an area of ongoing consideration and support the need for the Bank of England to consider this carefully and to apply the requirements on an internationally consistent basis in conjunction with other authorities and on the basis of the further work on internal TLAC under development at the FSB. The authorities should also consider these issues in conjunction with the industry and AFME would be happy to facilitate further discussion.

However, while the proposal in the consultation paper states that the "Bank intends to calibrate internal MREL that is as consistent as possible with the Final TLAC Standards" and applies some of these principles, there are a number of areas where the Bank of England's proposal appears to divert from the TLAC principles, including:

a) The scope of entities which are subject to an internal MREL requirement in excess of minimum capital requirements should be aligned with the scope of internal TLAC under the TLAC Term Sheet, i.e. to be applied only at material sub-groups, as defined in the TLAC Term Sheet.[5] Subsidiaries which do not form part of a material sub-group (and are not themselves a resolution entity) should not be subject to an internal MREL requirement in excess of their existing minimum capital requirements. The criteria for identifying such non-material subsidiaries should also be clarified.

[4] See GFMA/IIF response to the FSB consultation on temporary funding in resolution, available at: http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=13631

[5] Paragraphs 16 and 17 of the TLAC term sheet.

b) As set out in the TLAC Term Sheet, "the primary objective of internal TLAC is to facilitate cooperation between home and host authorities and the implementation of effective cross-border resolution strategies by ensuring the appropriate distribution of loss-absorbing and recapitalisation capacity within resolution groups outside of their resolution entity's home jurisdiction." We therefore believe that while a mechanism for the absorption of losses and the recapitalisation of subsidiaries within the same jurisdiction should be clarified as part of the resolution planning process, there should be no requirement for the pre-positioning of internal MREL resources in subsidiaries within the same jurisdiction once the top entity in that jurisdiction holds prepositioned MREL and meets the requirement on a consolidated basis. Home/host cooperation would not be an issue in respect of such entities and greater flexibility should be possible, for example in relation to unfunded commitments and capital contribution agreements, provided that these contain appropriate triggers. The authorities and investors would need to ensure that a loss transfer and recapitalisation mechanism was available but there would be no need for additional comfort in relation to the actions of another authority. We believe that having the flexibility to employ such an approach can be as effective and timely as pre-positioned resources at recapitalising the subsidiary.

   We therefore believe that greater flexibility is appropriate and that rather than setting inflexible requirements for the pre-positioning of internal MREL in domestic subsidiaries of resolution entities, the Bank of England should apply a more flexible requirement as part of its resolution planning process which requires that there is a credible plan for the transfer of losses and recapitalisation of the subsidiary if required. Permitting some resources to be held at the resolution entity is likely to provide greater flexibility to the resolution authority and comfort to investors in the subsidiaries of the resolution entity that there are resources that could be utilised in the event of stress at any of the subsidiaries within the sub-group.

c) We suggest that the Bank of England should consider taking an approach which permits banks to hold a portion of internal MREL at the resolution entity. This approach would have the benefit of avoiding the difficulties in attempting to make use of resources which have been prepositioned at one subsidiary to meet losses that arise in another subsidiary in the resolution group. If necessary this could be reinforced with a capital contribution agreement obliging the resolution entity to recapitalise the subsidiary upon the occurrence of an appropriate trigger.

d) We welcome the proposal to apply "scaling" when calibrating internal MREL requirements to avoid consolidation effects that mean that the sum of the requirements set for individual entities within a group is greater than the equivalent requirement applied at the consolidated level. This is crucial to avoiding increased consolidated requirements. However the proposal does not expressly implement the requirement in paragraph 18 of the TLAC Term Sheet that "each material sub-group must maintain internal TLAC of 75% to 90% of the external Minimum TLAC requirement that would apply to the material sub-group if it were a resolution group". The Bank of England should apply the 75% to 90% range when setting internal MREL, with the default being the lower end of the range. It should also be clarified that the scaling should apply to the TLAC minimum requirement rather than the local standalone requirement. Otherwise there would be greater potential for the aggregate of individual requirements being greater than the consolidated external requirement.

e) The draft policy statement does not provide details of how the Bank of England would cooperate with resolution authorities in other jurisdictions in relation to the setting of MREL in accordance with the group resolution strategy. For example, as set out in the TLAC Term Sheet, internal TLAC requirements within the range of 75% to 90% should be determined by the host authority of the material sub-group in consultation with the home authority of the resolution group. This consultation requirement should be included in the Bank of England's statement of policy.

f) Importantly, clarification is necessary on the form of internal MREL. We note that the Bank of England intends internal MREL to be sufficiently subordinated so as to be capable of being written down without or ahead of the use of the stabilisation powers. Such instruments should however not be limited to regulatory capital instruments. It is also necessary to understand what this would mean from a double leverage perspective, where internal subordinated instruments are being funded by senior holding company instruments and how internal MREL would interact with capital buffers and MDA restrictions at a subsidiary level.

   Paragraph 5.5 (b) of the consultation paper states that "internal MREL resources must be capable of being written down or converted to equity without or ahead of any actual resolution of the operating entity which issues them". Paragraph 5.9 then goes on to state that "Non-regulatory capital debt instruments may also be able to meet this principle if they contain a contractual clause which would achieve the same effect, that is, they could be written down or converted to equity when the operating entity reached PONV".

   We are concerned that the effect of these requirements appears to be to accelerate the point at which the Bank of England would intervene and require non-regulatory capital internal MREL instruments to be written down or converted to equity as this would occur at PONV rather than resolution. Consequently, non-regulatory capital debt instruments that are gone-concern loss absorbing instruments would effectively become going-concern loss absorbing instruments given that they would absorb losses before resolution. We believe this will create uncertainty as to the point at which the Bank of England, in the capacity of UK resolution authority, would take action in respect of a UK subsidiary of a non-UK group.

   It is also unclear what the economic difference would be between a regulatory capital debt instrument and a non-regulatory capital internal MREL instrument should the write down/conversion triggers be the same. We believe this could have material implications for the pricing of non-regulatory capital debt instruments.

   We note that the criteria in paragraph 5.5 are described as principles and we consider it important that the Bank of England does not apply them rigidly but rather considers whether write down or conversion of non-regulatory capital internal MREL instruments at PONV would be appropriate given the resolution strategy of the group.

We welcome the confirmation that the Bank of England will discuss the distribution of MREL resources with institutions as part of setting MREL. We also support the proposal that individual MREL will be set equal to minimum regulatory capital requirements for entities within a group which could feasibly enter insolvency upon the resolution of the group as a whole. Further clarity would be welcome as to how this determination will be applied in practice, for example in the case of a small wholesale bank. Where the Bank of England makes such a determination, the relevant subsidiary should not contribute to the consolidated MREL requirement for the group/resolution group. Similarly where such an entity forms part of a material sub-group, it should not contribute to the internal MREL requirements for that sub-group.

In addition to addressing consolidation effects in relation to the consolidated group, scaling of internal MREL should also be applied to address consolidation effects at the resolution entity level to avoid increasing external MREL requirements for resolution entities as a result of consolidation within the resolution sub-group.

Additional clarity would be welcome in relation to the Bank of England's expectations regarding avoiding double leverage, in particular how this will be applied in respect of internal TLAC.

External MREL eligibility requirements

We welcome the additional clarity regarding the Bank of England's approach to the eligibility criteria for external MREL. While the Bank's preference for structural subordination is clear from the consultation paper, further clarity should be provided as to the statement in paragraph 4.8 to ensure that MREL resources are subordinated to operating liabilities "*in the first instance* using structural subordination" (our emphasis) and how this fits with paragraph 6.4 which states that "the Bank will require institutions (other than building societies) subject to a bail-in strategy to structure their liabilities to achieve structural subordination of external MREL resources."

Further clarity would also be welcome on the bank's expectations regarding the degree of ineligible liabilities that may rank *pari passu* with MREL at the resolution entity. While paragraph 5.14 of the consultation paper provides some elaboration on this point, this does not appear to be reflected in the draft policy statement. We suggest that the policy statement should confirm that the Bank will apply the ability under the TLAC Term Sheet for excluded liabilities of up to 5% of the resolution entity's eligible external TLAC to be permitted. However the Bank should also clarify how it intends to apply the requirements of article 3 of the draft Regulatory Technical Standards on the criteria for determining MREL and the 10% threshold set out therein. We propose that the Bank of England should confirm that resolution entities may hold excluded liabilities (defined as discussed below) of up to 5% of the resolution entity's eligible external TLAC and that the Bank of England will then consider the impact of any additional excluded liabilities in excess of this 5% allowance in accordance with article 3 of the draft RTS.

Unlike the TLAC Term Sheet, the BRRD does not include a definition of "excluded liabilities" and importantly the scope of excluded liabilities under the TLAC Term Sheet is different from liabilities that are not eligible for MREL. For example, liabilities with a remaining maturity of less than 12 months, but which are not excluded from bail-in under article 44(2) BRRD should be permitted to be held *pari passu* with MREL without counting towards the 5% limit as they would be bailed in alongside MREL and would not give rise to any NCWOL issues. Accordingly the 5% limit should apply only to liabilities that are excluded from bail-in under article 44(2) BRRD and this should be confirmed in the Bank of England's policy statement.

Some further elements of the eligibility requirements would benefit from additional clarity, including what instruments are viewed as being those "the value of which is significantly dependent on derivatives". Many types and classes of callable notes have been issued by banks which would not be considered to be structured notes, but it could be difficult to develop an appropriate definition that would not exclude them. Further clarity should be provided to confirm that, for example, it would not extend to vanilla fixed rate notes. We understand the Bank's concerns regarding its ability to assess the value of eligible liabilities rapidly in resolution. However, we suggest that rather than excluding a fairly vague category of instruments from MREL eligibility, it would be preferable for the Bank to specify its criteria positively, perhaps by including a reference to valuation in paragraph 5.1 of the draft Policy Statement. Provided that these criteria can be met, permitting a broader range of types of instrument within the scope of MREL would enable a more diversified investor base, which could reduce contagion in resolution and reduce the impact on institutions.

Consideration should also be given to ensuring that restrictions upon the activities of resolution entities do not prevent them from holding resources that could be used to recapitalise subsidiaries in a material sub-group.

We welcome the proposal not to apply additional minimum maturity requirements, which we do not consider are necessary. However, further clarity would be welcome as to how the Bank expects institutions to monitor the overall average maturity of their externally-issued MREL resources to ensure that temporary difficulties in accessing debt issuance markets would not be likely to cause a significant breach of MREL.

Disclosure

We agree that the disclosure of MREL will be important to enable investors to have greater clarity regarding the likely resolution strategy and the impact that a resolution is likely to have on them. Greater clarity is required to support market discipline and enable ratings agencies and investors to appropriately price risk, which will ultimately be reflected in the price of banking services and products to end users. Appropriate disclosure is necessary to support the market for MREL issuance, particularly in the current volatile conditions where the market for Additional Tier 1 capital has been effectively closed. Such disclosure of MREL is also of great importance given the potential interaction of MREL and MDA, as previously discussed.

In particular, greater clarity is necessary for the positive impact of MREL on liabilities that are senior to MREL (including the impact of structural subordination of MREL on creditors of operating subsidiaries) to be realised. In addition to the disclosure of MREL, consideration should be given to disclosure of instruments which rank *pari passu* with MREL, for example instruments with a residual maturity of less than one year.

However, we encourage the Bank of England and other authorities to apply the international disclosure standards once finalised by the BCBS and welcome the Bank of England's proposal to consider disclosure requirements once the international standards have been finalised to avoid divergence between the UK and other jurisdictions.

While we agree with the need to ensure a consistent approach to disclosure and reporting requirements with other jurisdictions, this work should be completed as soon as possible to facilitate issuance, as the market is particularly sensitive to the quality of disclosure and reporting in this area. The Bank of England should work with the BCBS and the industry to determine how to coordinate disclosures regarding the creditor hierarchy, regulatory capital stack and the quantum of eligible MREL.

We suggest that the Bank of England should, in conjunction with authorities in other jurisdictions, also consider whether MREL requirements at a consolidated or resolution entity level should be made public, against the backdrop of increasing disclosure of pillar 2 requirements.

Treatment of MREL holdings

We also agree that the treatment of cross-holdings of MREL should be considered following the finalisation of the BCBS work on TLAC cross-holdings. GFMA has recently responded to the BCBS consultation.[6] As highlighted in the GFMA response, while we agree with the goal of avoiding contagion, it needs to be ensured that cross-holdings treatment does not adversely affect the market for TLAC, for example by penalising market-making in TLAC instruments.

Large exposures

We agree that the application of large exposures rules to internal MREL requires consideration and welcome the Bank of England's confirmation that it will work with the PRA to ensure that any interactions between the large exposures framework and MREL are managed appropriately. To the extent that internal MREL requirements would result in large exposure limits being breached, it is necessary that the large exposures regime should be revisited and amended. It is also important for the industry to understand these proposals sooner rather than later to enable an assessment of whether this would impact upon the overall quantum of external MREL that might be required.

AFME contacts

If you have any questions or would like to discuss these issues further, please contact any of the following:

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[6] The GFMA/IIF response is available at http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=13829