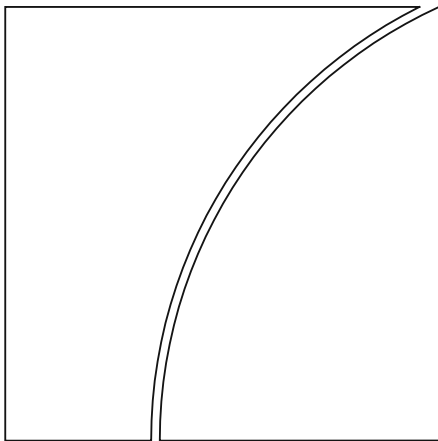




FSI Insights

on policy implementation

No 69

Loss-absorbing capacity requirements for resolution: beyond G-SIBs

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November 2025

JEL classification: G01, G18, G21, G33

Keywords: bail-in, calibration, D-SIB, eligible instrument, recapitalisation capacity, regulatory capital, resolution, subordination, systemic importance, TLAC, write down

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ISSN 2522-249X (online)

ISBN 978-92-9259-898-3 (online)

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Loss-absorbing capacity requirements for resolution: beyond G-SIBs ¹

Executive Summary

Following the Great Financial Crisis (GFC) that started in 2007, authorities have developed resolution regimes for banks. Since the 2011 adoption of the *Key Attributes of Effective Resolution Regimes for Financial Institutions*, developed by the Financial Stability Board (FSB), significant work has been carried out by resolution authorities nationally and under the aegis of the FSB to develop credible and feasible resolution plans for systemically important (“systemic”) banks and to ensure that those banks are resolvable under the resolution strategy or strategies set out in their plans.

Resolution enables authorities to manage the failure of a systemic bank in a way that minimises its impact on financial stability and economic activity without reliance on public funds. The core resolution strategies used to achieve this are based on the writedown and/or conversion of liabilities and shares of the failing bank to absorb losses and recapitalise its critical operations (bail-in), or the transfer of its critical functions to a financially sound recipient, or a combination of both. Loss-absorbing capacity (LAC) or other sources of funding are needed to support the execution of the chosen resolution strategy.

The funding required to implement the chosen resolution strategy may come from a range of sources. A primary source is LAC on the balance sheet of individual banks. LAC absorbs the losses and can also be used to recapitalise the bank in resolution or a successor, so that the failed bank’s critical functions can continue to operate. Other sources include industry-sourced funds – deposit insurance and resolution funds – and, ultimately, funding may also come from governments through exceptional public solvency support.

While a global LAC standard exists for the largest, most systemic banks, there is no equivalent alignment on how resolution of other banks should be funded. For the global systemically important banks (G-SIBs), the international resolution framework is supplemented by the FSB Total Loss-absorbing Capacity (TLAC) Standard, which sets a standard for a minimum LAC requirement for that set of designated institutions. Nevertheless, consistent with the scope of application of the Key Attributes, systemic non-G-SIBs are also expected to be resolved because of their likely impact in the event of failure. Those banks are therefore subject to resolution planning and resolvability requirements. Funding is a key aspect of resolvability. However, unlike G-SIBs, which are sufficiently comparable within the class to support an internationally coordinated approach to LAC requirements, the greater diversity of systemic non-G-SIBs suggests a need to tailor funding requirements to the characteristics of local banking markets.

This paper reviews and discusses the use of LAC requirements to support the resolvability of systemic banks other than G-SIBs. Recent episodes of banking turmoil have highlighted the importance of LAC for such banks. As part of its consideration of the lessons learned from the 2023 banking turmoil, the FSB stressed the importance of discussing the costs and benefits of requiring non-G-SIBs to issue LAC instruments to support resolution. This paper explores the approaches in six jurisdictions to designing and implementing resolution-related LAC requirements for banks other than G-SIBs. The

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selected jurisdictions are Australia, Canada, the European banking union, Hong Kong SAR, South Africa and the United Kingdom.

The scope of LAC requirements varies across the featured jurisdictions, but each is framed by systemic considerations. The way in which these considerations define the scope broadly falls into one of two approaches. In one case, the LAC requirement applies only to banks that have been formally identified as systemic, in accordance with a process for designating domestic systemically important banks (D-SIBs) or systemically important financial institutions (SIFIs). While other banks may be within the scope of the resolution framework, they are not required to issue additional resolution-related LAC. Under the second approach, the scope of application of a LAC requirement is determined in resolution planning.

The approach to LAC calibration also varies but is informed by the scope of application. When LAC requirements apply to a designated set of systemic banks, they usually consist of a uniform requirement for all those banks and are generally anchored in the regulatory capital framework. Where the scope of LAC requirements is linked to resolution planning, calibration is bank-specific, within parameters and based on the bank's resolution strategy and assessment of its resolvability.

Tailoring LAC calibration to individual banks may offer greater confidence that LAC levels will support resolution, but it increases complexity. While tailoring better reflects the diversity in business models, a bank's preferred resolution strategy and its operating environment, there may be a risk that it reduces the transparency and predictability of the framework. A complex set of adjustments, involving a greater element of judgment, is also burdensome for resolution authorities and possibly increases their exposure to challenge.

It is valid to consider whether LAC requirements can be streamlined or simplified. Simpler frameworks can deliver sufficient levels of LAC to facilitate resolution. It is not possible to calibrate LAC requirements for individual institutions with scientific precision, and there may be advantages in terms of simplicity in a less tailored approach, even if that could require authorities to quantify requirements conservatively.

While experience to date shows that banks have not had significant difficulties in meeting LAC requirements, there is a trade-off between the scope of the requirements and the nature of the instruments that are eligible to meet them. Where LAC requirements apply to a more diverse set of banks, including banks that have not traditionally issued significant volumes of debt, such banks may rely largely or entirely on CET1 to meet those requirements. However, authorities need to consider the risk that CET1 will be largely depleted at the point of failure. Subordinated, long-term debt may constitute a more reliable source of loss absorbency and recapitalisation capacity in resolution, but this is weighed against costs across the cohort of banks that are subject to LAC requirements, their access to international markets and the capacity of local markets to absorb it.

Section 1 – Introduction

1. **Resolution enables authorities to manage the failure of a systemically important (“systemic”) bank in a way that minimises its impact on financial stability and economic activity, without reliance on bailout and without loss to public funds.** In 2011, in response to the Great Financial Crisis (GFC), the Financial Stability Board (FSB) developed the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the Key Attributes) as a global standard for resolution regimes that apply to all financial institutions that could be systemic in the event of failure. Since the adoption of that standard in 2011, significant work has been carried out by resolution authorities nationally and under the aegis of the FSB to develop credible and feasible resolution plans for systemic banks and to ensure that those banks are resolvable under the resolution strategy or strategies set out in their plans.
2. **Funding is essential for effective bank resolution.** A key objective of resolution is to maintain the critical economic functions of a failing bank, to avoid the impacts of their precipitous withdrawal and the contagion effects of a disorderly failure and liquidation. The core resolution strategies used to achieve this are based on the writedown and/or conversion of liabilities and shares of the failing bank to absorb losses and recapitalise its critical operations (bail-in), or the transfer of its critical functions to a financially sound recipient, or a combination of both. Loss-absorbing capacity (LAC) or other sources of funding are needed to support the execution of the chosen resolution strategy.
3. **The funding required for resolution may come from a range of sources.** A primary source is LAC on the balance sheet of individual banks. LAC absorbs the losses and can also be used in resolution to recapitalise the operations that will be maintained, so that the failed bank’s critical functions can continue to operate without resort to public funding. Other sources include industry-sourced funds – deposit insurance and resolution funds – and, ultimately, funding may also come from governments through exceptional public solvency support.
4. **These various sources channel losses in different ways.** LAC pushes the costs of failure management to the bank’s shareholders and holders of loss-absorbing instruments, who absorb losses broadly as they would in liquidation. Industry-sourced funding mutualises certain costs across the banking sector, while public solvency support channels costs to taxpayers, although they may ultimately be recovered from industry through levies or taxes. The balance between these possible sources of funding is a policy decision for jurisdictions based on a range of considerations that include the structure of their banking sector, the level of losses and costs of historical bank failures and the depth of local capital markets. Jurisdictions may rely less on LAC if alternative sources will also be reliably available when an institution fails.
5. **At the international level, standards for resolution-related LAC are only in place for the largest, most systemic banks.** The FSB Key Attributes establish the principle that resolution should avoid exposing taxpayers to loss from solvency support for failed banks but contemplate that resolution frameworks may rely on a combination of those sources. For global systemically important banks (G-SIBs), the international resolution framework is supplemented by the FSB Standard on Total Loss-Absorbing Capacity (TLAC), which sets a standard for a minimum LAC requirement for the largest, most systemic banks. TLAC encompasses both minimum regulatory capital and additional (gone-concern) loss absorbency designed to absorb losses and recapitalise the G-SIB in resolution.
6. **There is no international standard that addresses resolution-related LAC for banks other than G-SIBs, and no international consensus on how resolution of non-G-SIBs should be funded.** The scope of the TLAC Standard reflects the consideration that a standard on LAC would be most suitable for G-SIBs given their cross-border nature and the fact that they are sufficiently comparable to support an internationally coordinated approach. By contrast, systemic banks below the level of G-SIBs are more

diverse and more shaped by national market specificities, suggesting a greater need to tailor requirements to local conditions.² Nevertheless, consistent with the scope of application of the Key Attributes, systemic non-G-SIBs are expected to be resolved because of the likely impact of their failure. Those banks are therefore subject to resolution planning. This paper looks at the use of LAC requirements to support the resolvability of those banks.

7. **Recent episodes of banking turmoil have highlighted the importance of LAC for banks other than G-SIBs that could be systemic in failure.** The US regional bank failures of 2023 were characterised by the severity of the depositor runs, and the costs of failure management. In their aftermath, it has been noted that such costs might have been reduced if those banks had had additional balance sheet LAC, which could have protected uninsured deposits from loss and made it more likely that a resolution sale could comply with the statutory least cost test and avoid the need for a systemic risk exception (see Gruenberg (2023) and FSB (2023)).

8. **The FSB has recognised that LAC may be appropriate for some banks other than G-SIBs.** As part of its consideration of the lessons learned from the 2023 banking turmoil, the FSB stressed the importance of discussing the costs and benefits of requiring some non-G-SIBs to issue LAC instruments to support resolution (FSB (2023)). It also published a statement on the importance of resolution planning and LAC for banks that could be systemic in failure (FSB (2024)). The statement noted the relevance of LAC for orderly bank resolution, not only through bail-in but also when using transfer tools. It also set out its benefits, which include mitigating the risk of deposit runs, reducing negative systemic effects and avoiding reliance on public funds. It recommended that authorities consider the need for additional LAC to support their ability to resolve banks other than G-SIBs without severe systemic disruption, while acknowledging that any local implementation needs to be adapted to the characteristics of the jurisdiction's banks and banking systems.

9. **Some jurisdictions have extended requirements for resolution-related LAC beyond G-SIBs to other banks.** Such initiatives in most cases pre-date the 2023 banking turmoil. In some jurisdictions, the extension is broadly an application of the TLAC framework, with minor modifications, to identified domestic systemically important banks (D-SIBs) or a broader category of banks that are determined to be systemic. In other jurisdictions, all banks within the scope of their resolution frameworks are potentially subject to LAC requirements, but the need for additional LAC is assessed on a bank-specific basis as part of resolution planning, and the amount of LAC required is calibrated to support a bank's expected resolution strategy. As a result, the levels of LAC required vary under different approaches. There are also variations in the instruments that are eligible to meet it.

10. **This paper explores the approaches in six jurisdictions to designing and implementing resolution-related LAC requirements for banks other than G-SIBs.** They are Australia, Canada, the European banking union,³ Hong Kong SAR, South Africa and the United Kingdom. The selection was based on availability of published material and diversity in practices across the sample.⁴ Information was

² Although authorities may attach systemic importance to a non-G-SIB depending on country-specific factors, a common reference for Basel Committee member jurisdictions is its definition of domestic systemically important banks (BCBS (2019)).

³ This paper focuses on implementation of LAC requirements in the European banking union and, in particular, the approach of the Single Resolution Board in setting LAC requirements for individual banks. However, those requirements derive from the resolution framework that applies throughout the European Union. Accordingly, in some contexts, the paper refers to the European Union more broadly.

⁴ Besides the featured jurisdictions, some other countries – for example, Mexico and Switzerland – apply additional LAC requirements to D-SIBs. Additionally, in August 2023 US banking regulators issued for comment a proposed rule that would require certain large depository institution holding companies, US intermediate holding companies of foreign banking

gathered from that material and interviews with the competent authorities. The paper analyses their frameworks, focusing on the scope of banks to which the LAC requirement applies, how the requirement is calibrated, the types of instruments that are eligible to meet the requirement, policy considerations that guided the approach taken, and any challenges associated with issuance and compliance.

11. **This paper is organised as follows.** Section 2 summarises the key features of the FSB LAC standard for G-SIBs – including the minimum TLAC requirements, instrument eligibility and the role of TLAC in support of resolution strategies – as such features are also relevant for LAC requirements for non-G-SIBs. Sections 3 and 4 provide an overview of the LAC requirements for non-G-SIBs in the six jurisdictions and describe their scope of application. Section 5 discusses how LAC is calibrated under the featured frameworks, identifying two main approaches: one in which the LAC requirements are integrated with the capital framework, and another in which calibration is determined in conjunction with resolution planning. Section 6 discusses the characteristics of instruments eligible for LAC. Section 7 describes the experience of the featured jurisdictions with the implementation of the LAC requirements. Section 8 proposes concluding reflections on the design of LAC requirements for non-G-SIBs.

Section 2 – Overview of the TLAC Standard

12. **The FSB issued the TLAC Standard in 2015 as part of its work to ensure that resolution frameworks can be effective.** Developed in consultation with the Basel Committee on Banking Supervision (BCBS), the TLAC Standard provides a framework for jurisdictions to ensure that G-SIBs maintain sufficient LAC to support their orderly resolution, ensure the continuity of their critical functions in resolution, minimise the effects of a G-SIB failure on financial stability and reduce the exposure of taxpayers to loss (FSB (2015)). It supplements minimum capital requirements with an additional LAC requirement to facilitate recapitalisation in resolution. The decision to develop the framework for G-SIBs was based on their cross-border nature and the fact that they are sufficiently comparable to support an internationally coordinated approach. The standard consists of principles on the loss-absorbing and recapitalisation capacity for G-SIBs in resolution and a term sheet that implements the principles, including by specifying minimum requirements and the characteristics of TLAC-eligible instruments.

Minimum TLAC requirements

13. **The TLAC Term Sheet sets out minimum standards for external and internal TLAC.** External TLAC is issued to third-party investors by the entities within a G-SIB group that are expected to be subject to resolution actions under the group resolution strategy (“resolution entities”). External TLAC is intended to be written down or converted into equity in resolution to absorb losses and recapitalise the resolution group. The end-state minimum external TLAC requirement is at least 18% of the resolution group’s risk-weighted assets (RWA) and at least 6.75% of the Basel III leverage ratio denominator, excluding applicable regulatory buffers. Internal TLAC is LAC that resolution entities have committed to material subgroups

organisations and certain insured depository institutions to issue and maintain a minimum amount of long-term debt. The aim of the requirement, if adopted, would be to increase the resilience and resolvability of the relevant banks. Following the premise that the banks in question pose less risk than G-SIBs, the proposed requirement would be lower than TLAC, ie 6% of risk-weighted assets, 3.5% of average total consolidated assets and, where applicable, 2.5% of total leverage exposure (FDIC et al (2023)). No further action has been taken to date.

(FSB (2015)).⁵ Subsidiaries within such subgroups are not expected to be subject to resolution actions under the group resolution strategy, and internal TLAC is a mechanism to facilitate the transfer of losses from those subsidiaries to the resolution entity. This is achieved by the issue of eligible instruments by subsidiaries to the resolution entity, which can absorb losses in the event of a resolution. Internal TLAC requirements are between 75 and 90% of the external minimum TLAC requirement that would apply if the material subgroup were a resolution group.

Features of eligible instruments

14. **The TLAC Term Sheet sets out eligibility criteria for TLAC instruments and specifies certain liabilities that should be excluded from TLAC.** For TLAC to achieve its objectives, authorities must be sufficiently confident that LAC will be available and able to absorb losses at the point of non-viability. The eligibility criteria and exclusions are designed to achieve that. To be eligible to meet TLAC requirements, instruments must be fully paid in, unsecured, not subject to setoff or netting rights, have a minimum remaining maturity of at least one year or be perpetual, and not be eligible for early redemption by the holder, among other requirements. Liabilities that are not considered to be credibly or reliably loss-absorbing in resolution – because of the impact of writing them down, their complexity or their legal nature and the rights they confer – are excluded from TLAC. These include insured, uninsured and short-term deposits; liabilities arising from derivatives; debt instruments with derivative-linked features (structured notes); non-contractual liabilities; preferred liabilities to senior unsecured creditors pursuant to applicable insolvency law; and liabilities excluded from bail-in by the governing law.

15. **Further requirements are designed to support credible loss absorbency.** The aim is to ensure that writedown or conversion of TLAC instruments will be legally enforceable. For example, authorities should be able to write down or convert TLAC without material risk of successful legal challenge or without incurring the obligation to compensate creditors under the “no creditor worse off than in liquidation” (NCWO) safeguard. They must also be confident that TLAC instruments are able to absorb losses without risk of contagion, disruption to critical functions or significant financial instability. Accordingly, those further requirements relate to subordination, governing law, triggers for writedown or conversion and cross-holdings of G-SIB TLAC instruments.

- **Subordination** – To ensure losses are absorbed by shareholders and unsecured creditors in the appropriate order in resolution, TLAC-eligible instruments must be contractually, statutorily or structurally subordinated to excluded liabilities in the event of a bail-in. In addition, subordination reduces the risk of NCWO claims which may occur if instruments subject to bail-in rank *pari passu* with excluded liabilities.
- **Governing law** – External TLAC instruments may be issued pursuant to the laws of the issuer’s home or a foreign jurisdiction. However, G-SIBs must ensure that the bail-in powers under the home resolution framework to write down or convert TLAC are enforceable under the governing law of the TLAC instrument.
- **Triggers** – External TLAC instruments should contain a contractual trigger or be subject to a statutory mechanism that enables the resolution authority to effectively write it down or convert it into equity in resolution.

⁵ A material subgroup comprises an individual subsidiary or a group of subsidiaries that are not resolution entities and that, on a solo or sub-consolidated basis, meet certain quantitative criteria relating to its share of RWA, leverage exposure or income generated relative to the G-SIB group, or are material to the exercise of the G-SIB’s critical functions (see Section 17 of the TLAC Term Sheet).

- **Cross-holdings by G-SIBs** – To reduce the risk of contagion, G-SIBs should limit holdings of TLAC issued by other G-SIBs or be required to deduct such holdings from their own TLAC resources or regulatory capital.

Section 3 – Overview of non-G-SIB LAC frameworks

16. **The approaches taken by the jurisdictions that have adopted LAC requirements for non-G-SIBs fall into three broad categories.** The LAC frameworks of the featured jurisdictions can be classified into categories defined by the scope of application (ie whether the requirement applies to a defined set of systemic banks or is linked to resolution strategy) and the extent to which the LAC requirements are uniform for the banks in scope or tailored to individual banks.⁶ On this basis, and with some degree of simplification, the six featured jurisdictions fall into three categories. Table 1 illustrates this schematically and the rest of the section explains it in more detail. Box 1 describes the motivation behind the chosen approach in the featured jurisdictions.

Categorisation of LAC frameworks			Table 1
Calibration	Application scope	Advance systemic designation	Link to resolution planning
Uniform LAC requirement		Australia* Canada	
Tailored LAC requirement		[Hong Kong SAR**] South Africa	[Australia*] European banking union Hong Kong SAR** United Kingdom***

* In Australia, the application is currently narrow: a uniform LAC requirement applies to D-SIBs. In principle, other banks may be subject to additional LAC requirements based on resolution planning. However, the Australian Prudential Regulation Authority has stated publicly that it anticipates that most non-D-SIB banks will not be required to maintain additional LAC for resolution purposes.

** In Hong Kong, the planning assumption is that a bank with total consolidated assets exceeding HKD 300 billion should be subject to LAC requirements. Implementation has been completed for D-SIBs and is now being extended to other locally incorporated banks.

***From 1 January 2026, only those UK banks with a bail-in preferred resolution strategy will generally be required to hold LAC in addition to capital requirements.

17. **Although the amount of LAC required is designed to deliver a common objective – support for orderly resolution – approaches to calibration and the methodology used vary across frameworks.** The differences arise from the design of the requirement and its scope of application. Approaches to calibration of the LAC requirement fall into two broad categories. The first builds directly on the capital framework and imposes a uniform supplementary requirement to a bank's minimum capital requirement (MCR). The second integrates LAC calibration with resolution planning and sets LAC requirements for individual banks based on an assessment of the amount that will be needed to support a successful execution of the bank's preferred resolution strategy (PRS). The first approach is broadly associated with a scope of application that limits LAC to a defined set of identified systemic banks. The second is associated with LAC frameworks that link scope to resolution planning and a bank's preferred

⁶ Authorities use different terminology, such as authorised institution (AI) (Hong Kong SAR), authorised deposit-taking institution (ADI) (Australia), firm and bank. For simplicity, this paper uses the term "bank" throughout.

resolution strategy. This potentially covers a more heterogeneous set of banks and greater variation in the institution-specific PRS that informs LAC calibration. Like any schematic distinction, this is a simplification and some of the featured frameworks combine elements of both. Nevertheless, it is helpful to identify commonalities and differences across the featured jurisdictions, and the distinction is therefore used to structure the discussion in the paper. The rest of this section provides an overview of the featured LAC frameworks, while the following two sections discuss scope and calibration in more detail.

Overviews of LAC frameworks of featured jurisdictions

Australia

18. **The LAC framework builds on the well established capital adequacy framework and currently applies to D-SIBs.** The increased levels of loss absorbency are applied through a prudential standard on capital adequacy⁷ that imposes a higher minimum capital requirement for D-SIBs. No new instruments have been designated for this purpose: the additional LAC requirements can be met with any capital instruments that satisfy the eligibility criteria for CET1, AT1⁸ or T2 capital set out in a prudential standard on the measurement of capital.⁹ For AT1 and T2 instruments, this includes conversion and write-off provisions. In practice, banks meet their LAC requirements with qualifying T2 capital instruments. There is no statutory bail-in power in Australia, and as a result the contractual provisions for T2 instruments will be relied on for conversion to common shares or writedown at the point of non-viability. However, there is a statutory provision to ensure these conversion and write-off provisions operate as intended, notwithstanding any legal impediments. Implementation has been staggered. D-SIBs met interim requirements by January 2024 and must meet the full increased amount from 1 January 2026. The application of additional LAC requirements to other banks will be assessed on a case by case basis as part of resolution planning.

Canada

19. **The LAC framework applies to D-SIBs (including G-SIBs) and is closely aligned with the FSB TLAC Standard.** It was introduced in conjunction with the statutory bail-in regime to facilitate the open bank resolution of D-SIBs. D-SIBs may meet LAC requirements with regulatory capital and other LAC instruments, a narrow set of instruments that are subject to bail-in. The minimum requirement, expressed as both a risk-based ratio and a leverage ratio, aligns with international standards. In their resolution plans, the D-SIBs are required to demonstrate that they have sufficient LAC available for conversion in resolution. The Canada Deposit Insurance Corporation (CDIC), as resolution authority, assesses the sufficiency of LAC in its resolvability assessment. The LAC requirements were effective in 2018 with an implementation deadline on 1 November 2021.

European banking union

20. **A minimum requirement for own funds and eligible liabilities (MREL) applies to all banks that could be subject to resolution, but the calibration is bank-specific and linked to its resolution strategy.** The resolution authority, the Single Resolution Board (SRB), calculates MREL on an institution-specific basis for every bank that falls within its remit, taking into account its PRS and the outcome of its

⁷ APRA (2024b).

⁸ APRA announced in December 2024 that AT1 instruments will be phased out over an eight-year period ending in 2032 following the 2023 bank failures and concerns about the effectiveness of AT1 instruments in absorbing losses in a going concern as intended (APRA (2024a)).

⁹ APRA (2022).

resolvability assessment. MREL consists of two components: a loss absorption amount (LAA) and a recapitalisation amount (RCA). The default LAA is based on the MCR, while the RCA is the additional loss absorbing capacity that is deemed necessary to recapitalise the bank to levels sufficient to continue performing the activities for which it is licenced and, where appropriate, to command market confidence following resolution. For banks that are expected to be wound up rather than resolved if they fail, MREL may be limited to the LAA – effectively, the MCR that applies under prudential regulation. In all cases, resolvability is a guiding principle in the setting of MREL, and the SRB may adjust the RCA upwards or downwards based on characteristics of the bank affecting its resolvability. MREL requirements can be met with a broader scope of eligible instruments in comparison with the FSB TLAC Standard, with fewer exclusions, and requirements for MREL instruments to be subordinated varying depending on the characteristics of the bank (see paragraph 67 for further details). However, where the SRB assesses that a bank's MREL composition, combined with projections of the size and distribution of its losses, gives rise to a risk of successful claims for compensation under the NCWO safeguard, subordination requirements will be applied to mitigate that risk. The framework in the EU was initially issued in 2014 and effective in 2016. The policy has undergone several iterations since implementation, reflecting regular review and refinement through the resolution planning cycle.

Hong Kong SAR

21. **The application of the LAC framework is determined by the scope of the resolution framework and the resolution strategy for a bank.** While the framework is aligned with the FSB TLAC Standard, it has a broader scope. The planning assumption applied by the Hong Kong Monetary Authority (HKMA) is that a Hong Kong incorporated bank with total consolidated assets exceed HKD 300 billion should be subject to LAC requirements. To date, the HKMA has implemented LAC requirements for D-SIBs and is now extending the requirements to other locally incorporated banks above HKD 300 billion threshold. Since the five Hong Kong D-SIBs are part of non-Hong Kong G-SIBs and are expected to be resolved under a group resolution strategy, they typically issue LAC instruments on an intragroup basis. The levels of LAC required of a bank are determined based on its PRS. The LAC requirement to support a transfer strategy may be lower than that for bail-in. The LAC framework was issued in December 2018 and, since 1 January 2023, all D-SIBs have met their applicable LAC requirements.

South Africa

22. **The LAC framework applies to banks that have been designated as systemically important financial institutions (SIFIs) and their holding companies and includes both standardised and tailored elements.** The framework requires SIFIs to maintain additional loss absorbency, in excess of minimum capital adequacy requirements, for the purpose of recapitalisation in resolution. It includes the introduction of a new class of instruments created by statute – Flac instruments (not an acronym) – to facilitate a statutory bail-in under an open-bank resolution strategy. The qualifying criteria for Flac instruments are aligned with those for TLAC and the instruments rank senior to regulatory capital and junior to other senior liabilities in the creditor hierarchy. The minimum Flac requirement consists of a base minimum requirement that is standard to all SIFIs and an additional firm-specific requirement. The latter is designed to capture idiosyncratic risk and includes a market confidence premium designed to foster market confidence that the bank will be able to operate as a going concern following resolution. The implementation date for Flac requirements has been deferred to 1 January 2026 and will be phased in over a six-year period. However, calibration of the idiosyncratic Flac requirement will only be determined when firm-specific resolution planning is more mature.

United Kingdom

23. **As in the European Union, the LAC framework applies potentially to all banks that could be subject to resolution but MREL is set for individual banks based on the resolution strategy.** For all banks, MREL includes a loss absorption amount to cover losses that would need to be absorbed up to and in resolution. This is generally equal to a bank's MCR. Beyond that loss absorbency, MREL is set to support execution of the bank's PRS. Although the Bank of England determines the PRS individually for every UK bank and building society, it has published indicative quantitative thresholds to guide that determination (see Section 4). For smaller banks that are expected to be wound up with a modified insolvency strategy, MREL is generally set equal to MCR, with no recapitalisation component. Banks with a bail-in PRS are generally required to maintain sufficient MREL above their MCR to recapitalise the resolved entity and support continuity of its critical functions. Under the current framework, MREL may be reduced for banks with a transfer PRS to reflect the fact that less of the original balance sheet will need to be recapitalised compared with an open-bank bail-in. Under a revised approach that will apply from the beginning of 2026, MREL for banks with a transfer PRS may be set at a level equal to MCR (see Section 4 for further discussion). The MREL requirements in the United Kingdom can be met with a broad scope of eligible instruments that is consistent with the FSB TLAC Standard, and all MREL-eligible liabilities must be statutorily, contractually or structurally subordinated. UK Banks have been subject to MREL requirements since 2016.

Box 1

Motivation for the design of LAC frameworks

Australia

The LAC framework in Australia was developed with simplicity, efficiency and familiarity for market participants in mind while pursuing the Australian Prudential Regulation Authority's (APRA) primary objectives of financial safety and financial system stability. The framework relies on existing features of the regulatory capital framework and does not create new instruments. In Australia, statutory bail-in powers had not been adopted, and writedown and conversion rely on contractual triggers in capital instruments. The level of additional LAC for D-SIBs was based on historical losses, the requirements imposed by international peers, benchmarking against LAC levels of other large banks internationally and considerations of funding costs and market capacity (APRA (2018)).

Canada

The adoption of LAC requirements for D-SIBs in Canada was based on the high concentration of assets held by the six D-SIBs (including two G-SIBs) in the Canadian banking system and with consideration of their international footprint. A strong motivation for aligning the LAC framework with international standards was to maintain the D-SIBs' ability to compete internationally, facilitating their continued success (OSFI (2018)).

European banking union

MREL is integral to the EU bank resolution framework that was adopted in 2014 following the Great Financial Crisis. It is designed as a first line of defence to ensure all banks have sufficient LAC, beyond own funds, to pay for the cost of their failure based on their preferred resolution strategy and their resolvability as assessed by the SRB. For the largest banks, it also aims to ensure that, should funding from the Single Resolution Fund be required, the condition of the writedown or conversion of at least 8% of the bank's total liabilities and own funds can be met. The MREL framework has been revised to align it with the FSB TLAC Standard and to reflect lessons learned during the resolution planning cycles (European Systemic Risk Board (2024)).

Hong Kong SAR

The HKMA designed its LAC framework to be consistent with the FSB TLAC Standard, while taking into account the characteristics of the Hong Kong banking system. The objective of the framework is to ensure that locally incorporated banks have sufficient LAC to implement their PRS, which may involve the use of bail-in or transfer powers or contractual loss transfer within the group (HKMA (2024b)).

South Africa

In developing its LAC framework, the South African Reserve Bank drew on its experience in managing previous bank failures in which the options were severely limited by an absence of both bail-in powers and LAC. This reinforced a desire for LAC in excess of regulatory capital requirements. Although the statutory bail-in powers apply to all non-excluded liabilities, there was also a strong policy preference for a set of clearly identifiable instruments that can be bailed-in in a way that respects the creditor hierarchy, so as to limit the risk of legal challenge and exposure to NCWO compensation claims (SARB (2024b)).

United Kingdom

The UK MREL framework retains significant aspects of the EU framework, including its application to all banks, its link to resolution strategy and a broad scope of MREL-eligible instruments. However, the framework has evolved following the UK exit from the European Union. The latest amendments, adopted in July 2025, will take effect from 1 January 2026 and aim to simplify and consolidate the MREL framework, update quantitative thresholds and facilitate growth and competition for UK financial institutions, while maintaining financial stability protection. The MREL framework, remains aligned with international standards and the amendments also reflect lessons learned from its implementation (BoE (2021, 2025)).

Section 4 – Scope of application of LAC requirements

24. **The scope of application of LAC requirements varies across the six featured jurisdictions.** While the systemic impact of failure is relevant to scope in all frameworks, it operates in different ways. In two, the scope is limited to institutions that the authorities have designated as D-SIBs or SIFIs. In the others, the scope of the LAC requirement is not framed by systemic designation. However, the concept is incorporated either because D-SIBs are prioritised in a phased implementation, or because LAC is implemented through resolution planning. In the latter case, the preferred failure management strategy for a bank reflects the likelihood of it being systemic in failure.

Advance systemic designation

25. **In Canada and South Africa, the LAC frameworks apply only to banks that have been designated as systemic by the authorities.** Systemic designations have been based on the methodology developed by the BCBS for identifying D-SIBs. Each jurisdiction assesses whether the failure of the institution could cause significant disruption to the stability of the domestic financial system and economy by considering factors including, but not limited to, size, interconnectedness, substitutability, complexity and the critical functions they provide. While in Canada the BCBS methodology is used, the South African

Reserve Bank (SARB) has adopted a methodology that draws on that of the BCBS but adapts it for the specific characteristics of the financial system in South Africa.¹⁰

26. **In Canada, the statutory bail-in powers under the resolution framework only apply to D-SIBs, and implementation of TLAC mirrors that scope.** There are currently six Canadian D-SIBs, two of which are also G-SIBs, and collectively they account for 94% of the national banking sector assets (IMF (2025)). Other resolution tools are available for banks that are not D-SIBs, including bridge bank powers, temporary ownership or control by the CDIC with restructuring, financial assistance or payout and liquidation. Additional LAC is not required to support those measures. Any necessary funding, beyond the bank's residual resources, would be provided by the deposit insurance fund, which is funded accordingly and has a backup borrowing authority.

27. **In South Africa, although the resolution framework applies to all banks, Flac requirements are limited to an identified subset.** The requirement applies only to banks that have been designated by the SARB as SIFIs and their holding companies. The designated SIFIs comprise six banks which, owing to those characteristics, the SARB assesses would need to be resolved through an open bank bail-in strategy to maintain continuity of their critical functions. All other banks, which are not subject to Flac, are considered to have a low enough impact in failure that they could be closed and liquidated.

Prioritisation of designated systemic banks in implementation

28. **In Australia and Hong Kong, the scope is broader than designated D-SIBs, but the implementation of LAC requirements is guided by systemic importance, and D-SIBs have been prioritised.** In Australia, the resolution planning standard applies to significant financial institutions (SFIs), identified on the basis of size and complexity, and to non-SFIs that provide critical functions. There are currently 14 banks identified as SFIs, including four D-SIBs, which are designated in accordance with the BCBS D-SIB methodology.¹¹ The D-SIBs are subject to a specific increase in capital requirements, which comes fully into effect from 1 January 2026. In Hong Kong, LAC requirements apply to all locally incorporated banks (or their holding companies) which would be subject to the use of resolution powers (eg bail-in or transfer) under the PRS and are set as part of resolution planning. Since the HKMA has rolled out resolution planning gradually, starting with D-SIBs, the implementation of LAC requirements has been staggered.

29. **Over time, other banks may also be subject to LAC requirements as resolution planning extends beyond D-SIBs.** In Australia, other SFIs may be subject to LAC requirements based on case-specific need. The Australian Prudential Regulation Authority (APRA) will assess those banks individually, in the course of resolution planning, to ascertain whether additional LAC is required to achieve orderly resolution. However, APRA has stated publicly that it anticipates that most non-D-SIB banks will not be required to maintain additional LAC for resolution purposes. In Hong Kong, all D-SIBs have met their applicable LAC requirements since 1 January 2023, and implementation is now being extended to locally incorporated non-D-SIBs. The HKMA operates a planning assumption that banks with total consolidated assets exceeding HKD 300 billion should be subject to LAC requirements. Some of those banks also meet their LAC requirements.

¹⁰ The approach is based on risk-weighted indicators that cover: (i) size; (ii) interconnectedness and substitutability; (iii) global activity; and (iv) complexity. The first two each have a 40% weighting, and the others are each weighted at 10%. Each indicator is elaborated by sub-indicators. Recognising that the weightings and aggregation used in the numerical methodology may underestimate systemic significance, the SARB methodology also accommodates an element of judgment on the part of the Governor to ensure that all elements and risks are properly considered (see SARB (2019b)).

¹¹ The list of SFIs is published and updated annually.

Scope linked to resolution planning

30. **In the European banking union and the United Kingdom, the banks that require resolution-related LAC are identified in institution-specific resolution planning.** While all banks are subject to resolution planning, the resolution authority may determine that the preferred failure management strategy for a bank is winding-up. Where a bank is expected to be subject to resolution if it fails, its level of MREL is set in accordance with its PRS. The systemic nature of an institution is relevant to its preferred failure management strategy, and therefore to the level of MREL that is required. The Hong Kong framework is similar in that LAC requirements are determined through resolution planning. It is distinct in that it applies a planning assumption that, unless rebutted, applies LAC requirements to banks above a HKD 300 billion threshold.

Section 5 – Calibration of LAC requirements

31. **Broadly speaking, there are two approaches to the calibration of resolution-related LAC across the featured jurisdictions.** Under the first, the MCR is increased by a supplementary LAC requirement that is uniform for the banks within scope. Under the second, LAC requirements are determined for individual banks based on the bank-specific PRS and resolvability considerations.

Uniform requirement integrated with the capital framework

32. **In Australia and Canada, resolution-related LAC is integrated in the capital framework and expressed as an increase in minimum capital requirements.** In Canada, the TLAC requirements are designed to provide a non-viable D-SIB with sufficient loss-absorbing capacity to support its recapitalisation through an open bank bail-in strategy under which the CDIC takes temporary control or ownership of the bank. The TLAC measure consists of the sum of Tier 1 capital, Tier 2 capital and other TLAC instruments for those six banks. Similarly, in Australia the LAC requirement takes the form of a uniform percentage increase in the prudential capital requirements for D-SIBs. This approach is regarded as offering the advantage of simplicity and familiarity to market participants since it relies on established features of the regulatory framework.

Canada

33. **LAC for resolution is implemented through an integrated TLAC requirement.** The levels are set by the prudential supervisor – the Office of the Superintendent of Financial Institutions (OSFI) – and imposed through the TLAC guideline, which is included in the framework to assess a D-SIB's minimum capacity to absorb losses (see OSFI (2018, 2025)). The amount required is standard for all D-SIBs and is expressed in terms of both a minimum risk-based ratio of 21.5% RWA and a leverage ratio of 6.75%, on top of which are added the applicable D-SIB buffer requirements:

- *Target risk-based TLAC ratio:* 21.5% RWA + domestic stability buffer = 25% RWA
- *Target TLAC leverage ratio:* 6.75% + SIB leverage ratio buffer = 7.25% total leverage

34. **The TLAC requirement is calibrated to ensure that D-SIBs can withstand very severe losses and emerge well capitalised from resolution.** In setting those levels, OSFI sought to ensure sufficient loss absorbency and recapitalisation capacity so that a bail-in conversion could restore the D-SIB to viability and foster market confidence in its ability to operate. This uniform calibration is, intentionally, not designed to accommodate the resolution strategy or characteristics of the individual D-SIB (beyond its

risk profile as represented by RWA). OSFI does have the power to vary minimum TLAC for individual D-SIBs. Any decision to exercise that power would be context-specific and based on several factors, including as an assessment of the risk environment, the existing amount of the domestic stability buffer and the international context. In addition, as part of resolution planning, the CDIC requires D-SIBs to demonstrate that they have enough LAC to stabilise the resolution group(s); ensure that its subsidiaries do not enter into separate insolvency proceedings (unless it is envisaged by the resolution strategy); restore confidence in the bank; and avoid exposing taxpayers or the CDIC to loss.

Australia

35. **The LAC requirement for Australian D-SIBs increases their total capital requirements by 4.5 percentage points of RWA.**¹² This increase does not apply to other banks that are significant financial institutions and therefore within the scope of resolution planning. However, under its prudential standards APRA may determine higher prudential capital requirements for a bank and may change a bank's capital requirements at any time, including to incorporate additional capital required for LAC in resolution. The financial resources for resolution of those other banks will be assessed as part of the bank-specific resolution planning. To this extent, the Australian framework includes both types of approach. However, APRA has indicated publicly that it anticipates that most of those non-D-SIBs will not be required to maintain additional LAC for resolution purposes.

36. **The quantity of LAC for D-SIBs was chosen based on a range of factors that included international comparison and distinctive features of the Australian financial system.** The decision about calibration followed a public consultation based on a Discussion Paper (APRA (2018)), which sets out the rationale for increasing LAC to support resolution, explained the proposal to use the capital framework for this purpose, and described the considerations that would inform the calibration. Those considerations included: historical rates of losses in failures of systemic banks;¹³ the LAC requirements set by peer jurisdictions, including Canada, the European Union and Hong Kong; the LAC levels of large banks internationally; and the issuance of Tier 2 instruments by Australian banks and the implications for funding costs and market capacity to absorb additional issuance.¹⁴ The calibration also takes into account the conservative nature of its capital adequacy framework, which, as a result of differences in the definition of capital and the determination of RWA, requires Australian banks to maintain higher levels of capital against the same risks. The requirement for an additional 4.5% of LAC was therefore considered to ensure that Australian D-SIBs have ratios that are aligned with those of international peers.

Tailored calibration as part of resolution planning

37. **In the other featured jurisdictions, firm-specific considerations, assessed in resolution planning, have a role in the calibration of LAC.** A common feature of the LAC frameworks in the European banking union, Hong Kong, South Africa and the United Kingdom is that the resolution strategy of the individual bank, its resolvability or both, are taken into account when setting its LAC requirement.

38. **However, within this set, the way in which the bank's resolution strategy drives calibration varies.** In South Africa, the resolution component of a SIFI's LAC is calculated based on a post-loss balance

¹² There is no leverage-based measure.

¹³ This drew on the analysis of 13 (then) recent cases in which a bank failed or required public support that the FSB conducted when finalising the TLAC Standard. That analysis found the losses represented between 2 and 7% of RWA in most cases and around 11 to 13% in the three worst cases. Those findings had guided the FSB's end-state calibration of TLAC for G-SIBs as at least 18% RWA and 6.75% of the Basel III leverage ratio denominator.

¹⁴ From the outset, APRA anticipated that D-SIBs would meet additional LAC requirements with Tier 2, and that has proved to be the case.

sheet modelling its expected composition at the time of resolution, with a possible adjustment of part of that requirement for resolvability. Since all the banks to which the requirement applies have a bail-in PRS, there has as yet been no consideration of the LAC requirements for different resolution strategies. The HKMA proceeds from a starting assumption that the additional LAC required for resolution will be the same amount as a bank's minimum prudential capital requirements but may reduce that for banks with a credible transfer PRS.

39. **The banking union and UK frameworks share the same core concepts, but the banking union framework is more complex.** It involves potential firm-specific upward and downward adjustments in the recapitalisation amount required, taking into account the resolution strategy and considerations of resolvability and market confidence following resolution. The UK framework relies to a much lesser degree on firm-specific adjustments, particularly following a recent change in the approach to setting MREL for banks with a transfer PRS. The rest of this subsection describes the four jurisdictions' approaches to calibration in more detail.

South Africa

40. **The Minimum Flac Requirement (MFR) builds on the minimum capital requirement of designated SIFIs.** This increase is calculated based on the institution's estimated post-loss balance sheet and specific elements may be adjusted to reflect its resolvability. The objective of MFR calibration is that each SIFI maintains sufficient Flac and other qualifying instruments to recapitalise it, following an assumed depletion of regulatory capital, to a level that meets its MCR and provides the market with confidence that it will operate as a going concern following resolution.

41. **Calibration consists of a base MFR that is standard for all and an institution-specific requirement.** The base MFR is composed of the minimum capital adequacy requirement of 8% and the Pillar 2A requirement for systemic risk that applies to all banks.¹⁵ However, this is not a simple doubling of applicable MCR since it is calculated against the post-loss balance sheet, which SIFIs are required to calculate in accordance with instructions set out in the Prudential Standard.¹⁶ The institution-specific element – "idiosyncratic MFR" – consists of the Pillar 2B element of its capital adequacy requirement (designed to capture firm-specific risk) together with an additional market confidence premium which, as the name suggests, is intended to facilitate access to market funding for the resolved institution. Idiosyncratic MFR is also calculated using the estimated post-loss balance sheet and the market confidence premium is set within a range of 0–25% of the RWA of that balance sheet.

42. **Idiosyncratic MFR will be set as part of resolution planning since calibration takes into account the firm's resolvability.** Furthermore, the SARB has the power to grant a resolvability rebate that reduces a firm's market confidence premium by up to 15%. The rebate is only available for that additional element and is intended to provide an incentive for designated institutions to take measures to improve their resolvability.

43. **To date, because resolution planning is not yet sufficiently mature, the SARB has not set idiosyncratic MFR for any institution.** It is therefore premature to specify how resolvability will be factored into the calibration, although the SARB anticipates that qualitative factors such as the ability of a bank's management information systems to support resolution and the valuations required will be a relevant factor. The scope for divestment that would reduce balance sheet size in recovery measures or

¹⁵ The Pillar 2A requirement is currently set at 1%.

¹⁶ Paragraph 11.3 of Prudential Standard RA03: Flac Instrument Requirements for Designated Institutions. This requires institutions to deduct estimated losses (assumed to equal the amounts currently held towards meeting their minimum capital adequacy requirement) from the relevant asset class in accordance with the current risk weighting assigned to those assets. The residual values are assumed to represent the post-loss balance sheet of the institution in resolution.

post-bail-in restructuring may also be taken into account and will vary according to a bank's business model and degree of diversification. However, calibration will not take into account the possibility of balance sheet reduction through a partial transfer strategy. This is because the feasibility of a transfer depends on the availability of a suitable purchaser, and historical cases have led the SARB to conclude that this cannot be relied upon.

Hong Kong SAR

44. **The HKMA calibrates a bank's required LAC as part of resolution planning.** The requirements comprise both a minimum LAC risk-weighted ratio and a minimum LAC leverage ratio. LAC encompasses both a capital component designed to absorb losses before resolution and a resolution component, designed to fund orderly resolution. For a resolution entity, the resolution component is calibrated at the level that, through writedown or conversion, would generate the amount of capital required to execute the PRS. Where the PRS involves a bail-in, that amount needs to be sufficient to allow the bank (and its resolution group) to meet its minimum authorisation criteria and to regain market confidence, having regard to the capital depletion that can be expected in the runup to its failure.

45. **The starting point for the calibration of a bank's resolution component ratio is that it should equal the capital component ratio.** The objective is that where a bank experiences losses that wipe out its required regulatory capital, it would still have sufficient LAC remaining to be recapitalised in resolution. In developing this approach, the HKMA considered historical losses (including those analysed by the FSB when designing the TLAC Standard) and conducted a cost/benefit analysis of the impact of higher LAC requirements on banks in Hong Kong.¹⁷

46. **Proceeding from that starting point, the HKMA may vary the resolution component taking into account the resolution strategy.** LAC requirements are institution-specific, and the baseline for external LAC is expected to be twice the bank's regulatory capital requirement. The bank's PRS is a key consideration in a decision whether to vary that ratio. For banks with a bail-in PRS, that baseline level is expected to be maintained since the whole bank would require recapitalisation at the point of resolution.¹⁸ However, where a bank has a partial transfer PRS, a reduction in the resolution component ratio may be justified if, for example, the critical functions are limited and easily separable, so that fewer resources are likely to be required to support their transfer and recapitalisation. Similarly, less LAC may be needed to achieve a whole bank transfer of a smaller bank with relatively simple business where a suitable purchaser can be expected to provide the additional capital to support the transferred business in whole or in part because there is value to the purchaser (for example, business synergies).¹⁹

47. **Local banks that are material subsidiaries of a wider banking group are subject to internal LAC requirements.** Since those banks are expected to be resolved under the group resolution strategy, and are not points of entry into resolution, they are not required to issue external LAC. Rather, internal LAC is needed as mechanism for passing losses from the bank to the resolution entity, which issues external LAC. Internal LAC requirements are calibrated in accordance with the FSB TLAC framework: that is, the external LAC requirement that would apply if the bank were a resolution entity, subject to a scalar in the range of 75–90%.²⁰ The HKMA sets the scalar for each material subsidiary. As a default, it is set at

¹⁷ Broadly speaking, the costs related to lower investment and output, while the benefits would accrue from a lower probability and reduced severity of financial crises, delivering a material net benefit to the wider economy (see HKMA (2018), Section XII).

¹⁸ In applicable cases, it may be adjusted upwards, where necessary to comply with FSB TLAC floors.

¹⁹ See HKMA (2024b), Section 8.

²⁰ See HKMA (2024b), Section rule 11.1. The scalar range is 75–90% where internal LAC is to be issued to an entity incorporated in another jurisdiction. Where internal TLAC is to be issued to an entity incorporated in Hong Kong, the maximum percentage is 100%.

75%, but the HMKA may increase it where that is considered prudent, taking into account the PRS by which the subsidiary is covered, the likely availability of additional financial resources within its resolution group that could be expected to be used to restore to viability, and any other matters the resolution authority considers relevant.

European banking union

48. **MREL calibration is a firm-specific exercise, in which a range of adjustments are made in accordance with the resolution strategy, the features and situation of the bank and its progress towards resolvability.** External and internal MREL are set by the SRB for banks within its remit,²¹ and are calculated in terms of both a risk-based ratio and a leverage ratio, with both measures being required to be met in parallel. External MREL comprises the LAA, which reflects the losses that the bank should be capable of absorbing, and the RCA, representing the amount of LAC needed to recapitalise the bank to a level that allows its continued authorisation and operation, or the continuity of transferred functions, following the execution of its resolution strategy. The LAA consists of the combined supervisory Pillar 1 and Pillar 2 capital requirements and the leverage ratio requirement.²² The starting point for the RCA is the same as the LAA amount.²³ However, it may be adjusted upwards or downwards on a case by case basis to reflect a range of firm-specific features.

49. **Upward adjustment of the RCA may be driven by the need to ensure that the bank will be sufficiently capitalised following resolution to sustain market confidence.** The “market confidence charge” aims to enable the resolved bank to continue providing critical functions and to attract market funding for a year while its post-stabilisation restructuring plan is implemented. The reference amount for the market confidence charge is the combined buffer requirement (excluding any countercyclical buffer) that would apply to the bank after resolution, but that may be raised or lowered as necessary to achieve the objectives of the charge. The SRB’s policy is that a downward adjustment should not exceed 20%. MREL may also be reduced by up to 20% of the reference amount if the SRB is satisfied with the bank’s progress towards resolvability. Other upward adjustments to the RCA are also possible, for example, if the SRB considers them necessary to meet the statutory resolution objectives.²⁴

50. **Notwithstanding possible upward adjustments, the SRB’s approach to MREL calibration might be broadly characterised as firm-specific, downward adjustments from a high starting point.** Possible downward adjustments relate to the resolution strategy and balance sheet size. For example, the RCA may be reduced if the bank’s post-resolution balance sheet is expected to shrink through measures under binding restructuring plans or credible and feasible recovery options. Any such reduction will take account of the expected impact of the actions in question, such as disposals or deleveraging, on the total

²¹ According to the most recent figures, in 2024 there were 114 banks within the SRB’s remit. These are entities and groups that are directly supervised by the ECB for reasons of their significance based on factors such as size, economic importance and cross-border activities; and other cross-border groups. For other EU banks, MREL is set by the national resolution authority of their home member state, under the same framework and provisions for upward and downward adjustments that apply to the SRB.

²² A bank that is expected to be subject to liquidation will generally only have to meet an LAA. However, the SRB can set an add-on to the LAA component of MREL for such a bank if justified for reasons of financial stability.

²³ This overview simplifies for the purposes of this paper. MREL for resolution entities is set at the consolidated level of the resolution group, and the minimum supervisory Pillar 1 and Pillar 2 requirements that constitute the LAA are the consolidated ones. Where the perimeter of the resolution group differs from the prudential one, the SRB estimates the Pillar 2 and combined buffer requirements to be used. The same CET1 instruments cannot be used to meet the risk-based MREL requirement and the capital buffer.

²⁴ The leverage-based MREL amount may be raised up to 8% of total liabilities and own funds if the SRB considers it necessary to ensure that a bank has sufficient LAC to meet required writedown of at least total liabilities and own funds as a condition for use of resources from the Single Resolution Fund to support its resolution.

risk exposure amount and leverage exposure of the bank's post-resolution balance sheet. Limits are set for such anticipated balance sheet reductions: for example, the expected impact of a recovery measure that may be taken into account is capped at a reduction of 5%. These adjustments are available irrespective of the bank's PRS.

51. **The RCA may be reduced for banks with a PRS involving a partial transfer to reflect the smaller balance sheet that would need to be funded following resolution.** Transfer transactions include use of a bridge bank or an asset separation tool, in addition to a sale of business to a private sector purchaser. The downward adjustment is made by applying a scaling factor of between 15 and 25% to the total assets and calculating the RCA requirement on that basis. Within that corridor, the SRB decides the factor to be used in a specific case based on considerations of the size of the bank, the proportion of impaired assets on its balance sheet, the nature of its depositor base, levels of uncertainty in valuation that may affect marketability and an assessment of its progress towards resolvability.

52. **Key considerations for the SRB in determining whether to reduce the RCA for a partial transfer PRS, and by how much, are the bank's marketability and the feasibility of a sale.** That determination will reflect the separability analysis, the likelihood that there will be suitable purchasers and the level of confidence that the transfer could be executed. If a bank with a transfer PRS is not yet considered to be sufficiently marketable and resolvable, an adjustment will not be made. Overall, about 10% of the banks for which the SRB is responsible have a transfer-based resolution strategy, but not all of them are yet subject to an MREL reduction based on that strategy.

53. **The SRB's MREL policy has been subject to review and the framework may be revised.** In 2023, the SRB conducted a public consultation on the future of MREL policy which sought views on, among other things, the market confidence charge and adjustments for resolution strategies that envisage a combination of bail-in and transfer tools.²⁵ In the light of consultation responses, the SRB adapted its approach to the calibration of the market confidence charge to take account of banks' progress towards resolvability.²⁶ However, it is reflecting on how to incorporate combinations of resolution tools in its resolution planning and has not yet developed its approach. Scope for fundamental change is limited because the SRB's approach to MREL calibration is bound by the EU legal framework, which includes detailed rules on how MREL may be adjusted to accommodate firm-specific features and on the subordination requirements for the instruments used to meet MREL (see Section 6).²⁷

United Kingdom

54. **The UK approach to MREL calibration shares core elements with the EU framework but has changed in some areas.** The commonalities derive from the scope of resolution planning and the fundamental principle that MREL is set for individual institutions and groups with the goal of ensuring that the PRS can be executed in a way that achieves the resolution objectives. Accordingly, under the UK framework the PRS is integral to MREL calibration. The statutory criteria that govern the way in which the

²⁵ SRB (2023).

²⁶ SRB (2024b).

²⁷ Bank Recovery and Resolution Directive, article 45c. This article focuses on bail-in strategies, and the current framework does not elaborate in detail on the calibration of MREL for banks with transfer strategies. The European Commission proposal for reform of the EU crisis management and deposit insurance framework would add new provisions on the calibration of MREL for transfer strategies which recognise that the RCA will generally be smaller compared with those for an open bank bail-in strategy. Considerations proposed are based on those currently used by the SRB, ie the size and business model of the resolution entity; the expected transfer perimeter; the type, expected value and marketability of the instruments to be transferred; and whether the PRS envisages the combined use of the "asset separation tool" by which certain – typically impaired – assets can be removed for separate management. It would give an explicit statutory basis to the adjustments for transfer strategies and promote an aligned approach by EU national resolution authorities. It is not clear what form this provision will take in the package as finally adopted, but some version of it is expected to have been agreed.

Bank of England sets MREL include the need to ensure, in appropriate cases, that the institution has sufficient own funds and eligible liabilities to absorb losses and restore its capital and leverage ratio to a level necessary to enable it to comply with the conditions for authorisation and carry on the activities for which it has been authorised. A loss absorption amount is common to all banks' MREL, and it is set to cover the losses that would need to be absorbed up to and in resolution. That amount is generally set at the institution's MCR.²⁸ The extent to which an institution's MREL is set above MCR is guided by its PRS and the quantum of the recapitalisation component that the Bank of England considers necessary to execute that strategy.

55. **The Bank of England has set out the factors that it will consider when determining a bank's PRS and how that determination may affect its MREL calibration.** Those factors comprise quantitative thresholds and qualitative considerations that guide whether the PRS will be an insolvency procedure under the applicable modified insolvency regime,²⁹ a transfer transaction or a bail-in strategy. In 2025, the Bank of England published a revised statement of policy on its approach to setting MREL that updates the indicative thresholds for each strategy, effective from January 2026; see Box 2 for a description of the current and revised thresholds. The revisions to the total assets thresholds reflect nominal UK GDP growth rather than a change in the risk appetite of the Bank of England, and do not represent a material change in policy approach. However, certain changes made in parallel to MREL calibration are more consequential.

Box 2

The Bank of England's indicative thresholds for resolution strategies

The Bank of England (BoE) publishes indicative thresholds that guide its assessment of the appropriate PRS for a bank. The Statement of Policy on its approach to setting MREL that is in force until the end of 2025^① sets out the following thresholds:

- 40,000–80,000 transactional accounts: the BoE will consider whether a transfer PRS is appropriate.
- Above GBP 15–25 billion total assets: the BoE will consider whether a bail-in PRS is appropriate.

Institution-specific qualitative factors are also considered. Factors indicating a partial transfer, rather than a PRS based on bail-in, may be possible include whether the bank's business structure makes the rapid separation and transfer of its critical functions feasible, the ability of its management information system to provide the necessary information to support a transfer within the required time frame, the likely attractiveness of its business to a private sector purchaser and the likely number of potential purchasers. For a bank below those thresholds, a modified insolvency procedure might be appropriate if it does not provide significant amounts of transactional banking services or other critical functions and the impact of its failure is unlikely to cause disruption to the wider UK financial system.

Revised thresholds to apply from 2026

A revised Statement of Policy, effective from 1 January 2026, increases the indicative total assets threshold to reflect nominal economic growth in the period since 2016, when the current thresholds were set.^② Under the revised approach:

- Institutions with total assets exceeding GBP 40 billion: a bail-in strategy is generally expected.

²⁸ While the starting point adds applicable capital buffers to the loss absorption component of MREL, the Bank of England may exclude them if it considers them not to be relevant to loss absorption in resolution. Since the CET1 cannot be used to meet both MREL and buffer requirements simultaneously, the Bank of England expects to exercise that discretion.

²⁹ The UK framework includes modified insolvency procedures for banks and building societies, a key purpose of which is to prioritise depositor protection and facilitate a rapid payout of insured deposits.

- Institutions with total assets between GBP 25 billion and GBP 40 billion: the BoE will consider whether a transfer or bail-in strategy is more likely to be appropriate, taking into account the qualitative factors mentioned above relating to the credibility and feasibility of a transfer strategy.
- Institutions with total assets not exceeding GBP 25 billion – the bank is likely to be able to enter a modified insolvency procedure, subject to the considerations related to the impact of the failure and the amount of transactional banking services or other critical functions mentioned above. The BoE considers that the latter condition will generally be met if the number of transactional bank accounts is below the 40,000–80,000 range.

① BoE (2021). ② BoE (2025).

56. **MREL calibration for banks with a bail-in PRS is unchanged under the revised policy.** D-SIBs and other UK resolution entities must maintain the higher of two times the sum of its Pillar 1 and Pillar 2A requirements and two times the applicable leverage ratio requirement. G-SIBs are subject to an enhanced requirement that is consistent with the FSB TLAC Standard.³⁰ The objective is to ensure that the most systemic banks have “two full tanks” of loss-absorbing capacity, one for going-concern loss absorption and the other to recapitalise the whole balance sheet in the event of resolution. Distinct from the EU approach, the UK framework does not incorporate an explicit market confidence charge, although the Statement of Policy notes, regarding the MREL requirements for G-SIBs, that a level below the internationally agreed minimum would not be expected to be sufficient to ensure market confidence.

57. **Similarly, there is no change under the revised policy to MREL calibration for banks with a strategy based on insolvency.** The recapitalisation component for institutions that are expected to be subject to the applicable modified insolvency procedure if they fail is set at zero. Accordingly, the MREL for such institutions is equal to their MCR excluding any applicable capital buffers.

58. **The revised MREL policy does change the likely external MREL requirements for banks with a transfer strategy.** Under the original approach, the Bank of England could reduce the recapitalisation component for a bank with a transfer PRS to reflect the fact that less than the entire balance sheet would need to be recapitalised in resolution.³¹ Using that discretion, the Bank of England adjusted the MREL for the two UK banks with a transfer PRS. That adjustment resulted in an end-state MREL requirement for each bank of 1.3 times their binding minimum capital requirement (compared with the roughly two times the minimum capital requirement that applies for firms with a bail-in strategy).³²

59. **Under the revised policy, the Bank of England does not expect to set MREL above MCR for banks with a transfer strategy.** As a result, smaller banks will have MREL set at equal to MCR irrespective of whether their PRS is modified insolvency or a transfer. The effect is to enable institutions with total assets between GBP 25 billion and GBP 40 billion that have a transfer strategy to grow to the upper bound without necessarily being subject to MREL above capital requirements: within this range the Bank of England may still determine that a bail-in PRS, with MREL above MCR, would be appropriate. The change in approach to MREL calibration does not affect other aspects of resolvability: transfer firms will continue to be subject to the required resolvability outcomes under the Bank of England’s Resolvability Assessment Framework.³³

³⁰ G-SIBs must maintain external MREL equivalent to the higher of: two times the sum of its Pillar 1 and Pillar 2A requirements; two times the applicable leverage ratio requirement or 6.75% (if higher); and 18% of RWA.

³¹ Subordination requirements applicable to MREL-eligible instruments might also be relaxed, depending on the nature of the liabilities that are expected to be transferred – see Section 6.

³² See Bank of England (2024).

³³ Bank of England (2019). The resolvability outcomes relate to adequate financial resources (covering liquidity, as well as MREL), continuity and restructuring, and coordination and communication.

60. **The revised MREL policy for banks with a transfer strategy responds to developments in the UK framework that introduce a new source of potential funding for small bank resolution.** Legislation adopted in 2025 established a new mechanism by which the UK Financial Services Compensation Scheme can provide funds to support small bank resolution using transfer powers – a sale to a private sector purchaser or use of a Bank of England-owned bridge bank – when it is in the public interest to do so.³⁴ The mechanism is intended to be used only once the regulatory capital of the failed bank has been written down. Funds used through this mechanism will be recovered from the industry through levies. This alternative source of funding makes it possible to reduce to zero the recapitalisation component of MREL for the small number of UK banks with a transfer PRS. Of equal significance, the mechanism can be used where a resolution transfer is used for a bank that was expected to be subject to a modified insolvency (and therefore was not required to maintain MREL above MCR).³⁵ The Bank of England does not intend to take the new mechanism into account when setting the MREL that firms with a bail-in PRS should meet.

Section 6 – Characteristics of instruments eligible for LAC

61. **In almost all the featured jurisdictions, the characteristics of debt instruments that are eligible for LAC are broadly comparable with those set out in the FSB TLAC Standard.** The eligibility criteria for TLAC, targeting stable and long-term instruments, are essential to ensure sufficient LAC is available and not diminished upon deterioration of a bank's financial situation. See Table 2 for an overview of those criteria.

62. **Jurisdictions differ in the breadth of instruments that may be used to meet LAC requirements.** Among the six featured jurisdictions, the broadest set of eligible instruments is under the EU and UK frameworks. In the UK framework, MREL-eligible instruments may in theory include uninsured deposits if non-preferred in insolvency and with a remaining effective maturity of one year or more. Under the EU framework, in addition to such uninsured deposits, liabilities that arise from debt instruments with embedded derivatives may also be eligible to meet MREL requirements. The HKMA has aligned its eligibility requirements for LAC debt instrument closely with the criteria outlined in the FSB's TLAC Standard. Canada's LAC requirements must be met by a narrow set of bail-in-eligible instruments that consists, in addition to regulatory capital, of long-term unsecured senior debt instruments that are tradable and transferrable along with preferred shares and subordinated debt that are not non-viability contingent capital.³⁶ The SARB has introduced a clear set of identifiable Flac instruments specifically for the purpose of bail-in conversion or writedown in resolution and at least one third of a SIFI's total loss-absorbing capacity must be met with Flac instruments. The rest may be met by regulatory capital. Australia

³⁴ The Bank Resolution (Recapitalisation) Act 2025.

³⁵ That was the case for Silicon Valley Bank (SVB) UK, which failed in March 2023 owing to the high-profile failure of its US parent. SVB UK was a relatively small bank with total assets amounting to approximately GBP 11.6 billion and had no critical functions within the UK financial system. It had therefore been expected to be subject to modified insolvency, but in the circumstances it was resolved using a sale-of-business transfer. Its regulatory capital was written down and no additional funding was required. However, the case highlighted the fact that it may be in the public interest to use resolution transfer powers for banks with transactional accounts below the indicative threshold for a transfer resolution strategy (GBP 40,000–80,000) based on the nature of the depositor base. For SVB UK, this largely comprised a concentrated set of clients in the UK innovation sector, to which the bank was also a significant lender.

³⁶ Non-viability contingent capital (NVCC) is non-common regulatory capital issued by banks containing contractual terms that allow for its automatic conversion into common shares at the point of non-viability (CDIC (2016)). It is not included in bail-in due to its convertibility feature: conversion is expected to have been triggered prior to resolution.

relies on regulatory capital instruments to support any additional LAC requirement more than absolute minimum regulatory capital requirements.

Characteristics of instruments eligible for LAC					Table 2
	Canada	European Union	Hong Kong SAR	South Africa	United Kingdom
	Other TLAC instruments	MREL	LAC debt instruments	Flac instruments	MREL
Instruments must be:					
Fully paid in	✓	✓	✓	✓	✓
Unsecured (or partially unsecured)	✓	✓	✓	✓	✓
No setoff/netting rights	✓	✓	✓	✓	✓
Remaining maturity > 1 year or perpetual	✓	✓	✓	✓	✓
Restrictions on early redemption	✓	✓	✓	✓	✓
Subordinated	Statutory	Varies across member states	Contractual or structural	Statutory, contractual, structural*	Statutory, contractual, structural*
Included liabilities:					
Insured deposits	x	x	x	x	x
Uninsured, non-preferred deposits (maturity > 1 year)	x	✓	x	x	✓
Sight deposits (original maturity < 1 year)	x	x	x	x	x
Liabilities arising from derivatives	x	x	x	x	x
Debt instruments with derivative-linked features (structured notes)	Few	✓	x	x	x
Tax liabilities	x	x	x	x	x
Minimum debt requirement	x	x	✓**	✓**	x
Investor restrictions	x	Varies across member states***	✓****	✓****	x
Governing law	Domestic, foreign****	Domestic, foreign****	Domestic, foreign****	Domestic, foreign****	Domestic, foreign****

✓ Applicable, x Not applicable.

Australia is not included in this table as it has not implemented a bail-in regime. As such, it does not have LAC instruments subject to conversion or writedown in resolution, resolution beyond the conversion or writedown included in the contractual terms of the LAC instruments.

* Structural subordination is preferred, if permitted by the corporate structure.

** Minimum debt requirement is one third of LAC.

*** Minimum denomination and/or requirement of professional investor.

**** Foreign governing law permitted with contractual recognition of bail-in provision.

Subordination

63. **Subordination of LAC instruments is important to ensure that they are a credible and reliable source of loss absorbency in resolution.** The FSB TLAC Standard specifies that TLAC-eligible liabilities should be subordinated to operational liabilities and liabilities that are excluded from TLAC. Operational liabilities are those on which the firm's performance of its critical functions depends, while excluded liabilities include insured and short-term deposits, liabilities arising from derivatives, preferred liabilities under the creditor hierarchy and any liabilities that cannot be written down or converted into equity without giving rise to material risk of successful legal challenge or compensation claims.³⁷ Subordination ensures that losses are absorbed in resolution following the appropriate hierarchy of claims and limits the risk of successful NCWO claims. These considerations are not specific to TLAC but are relevant to any LAC instruments that will be subject to bail-in. Subordination may be achieved in three possible ways: structural subordination, where LAC instruments are issued by a "clean" holding company that does not have operational liabilities; contractual subordination, where the terms of the instrument specify its subordination to excluded liabilities of the resolution entity; and statutory subordination, where the LAC instruments rank junior to excluded liabilities in the statutory hierarchy.

64. **Approaches to subordination of LAC instruments vary across the featured jurisdictions.** In four of the jurisdictions, there is no differentiation in subordination requirements between the banks in scope of the LAC framework.

- *Canada* – Other LAC instruments are statutorily subordinated to all excluded liabilities in a resolution, and the bail-in conversion terms set by the CDIC preserve the relative creditor hierarchy between instruments subject to bail-in.³⁸ In liquidation, however, other LAC instruments would rank *pari passu* with unsecured creditors, including excluded liabilities (FSB (2019)). In theory, this could result in NCWO claims and compensation payable by the CDIC to holders of other LAC instruments that are bailed-in in resolution if it can be demonstrated that their losses in relation to those converted instruments would been lower if the D-SIB had instead been subject to an insolvency procedure. However, the Canadian authorities are comfortable that, in practice, there is not material risk of success legal challenge.
- *Hong Kong* – LAC debt instruments must be either contractually subordinated to depositors and general creditors of the issuing entity or structurally subordinated through issuance by a Hong Kong-incorporated holding company with a minimal quantity of non-eligible liabilities and limited activities.³⁹ The statutory creditor hierarchy does not provide for the specific subordination of LAC debt instruments, and all LAC debt instruments issued in Hong Kong are subject to contractual subordination. The ranking of the instruments is set out explicitly in the terms and conditions of the instruments. In one case, LAC is also structurally subordinated since it is issued by a clean holding company that was established in Hong Kong to act as resolution entity for its subgroup (HKMA (2024a)).
- *South Africa* – LAC instruments rank senior to regulatory capital instruments and are statutorily subordinated to all other unsecured liabilities. Contractual subordination is also required, and

³⁷ See Sections 10 and 11 of the FSB TLAC Term Sheet.

³⁸ The CDIC must set the terms of conversion in a way that is consistent with the relative rankings of all the instruments that are converted through bail-in. That is, all equally ranking instruments must be converted in the same proportion and receive the same number of common shares per CAD of the converted claim, and holders of other TLAC instruments must receive more common shares per CAD of their claims converted than holders of subordinated bail-in eligible instruments (CDIC (2016)).

³⁹ That is, the amount of the holding company's liabilities (which are not LAC-eligible) that rank senior to or *pari passu* with its LAC instruments must be less than 5%. The activities of the holding company must be limited to issuing financial instruments, holding funding instruments issued by its subsidiaries and any related ancillary activities.

structural subordination through the issuance of external Flac instruments by the holding company is preferred (SARB (2024a)). The insolvency legislation has been amended to include Flac instruments to reduce the risk of NCWO claims. While bail-in powers extend to other unsecured liabilities, the SARB expects to restrict any use of such powers in practice to Flac.

- *United Kingdom* – As a general principle, all MREL must be subordinated. The Bank of England expects banks with a bail-in PRS to ensure that their external MREL resources are subordinated to operating liabilities using structural subordination, where permitted by the corporate structure.⁴⁰

65. **In the European banking union, minimum subordination requirements for MREL vary by the type of institution and, for some banks, are set having regard to bank-specific NCWO risk.** The legal framework differentiates between Pillar 1 banks, consisting of the largest or most systemic banks,⁴¹ and other banks within the scope of the resolution framework. Pillar 1 banks must meet the non-adjustable element of their MREL with regulatory capital or other eligible debt instruments that are subordinated to excluded liabilities.⁴² For non-Pillar 1 banks, the amount of MREL that must be subordinated is determined by the resolution authority, based on a bank-specific assessment of the possible NCWO risk that is conducted as part of resolution planning (SRB (2024a)). This is a complex exercise that requires projections, using accounting and historical market data, of the size and distribution of the losses for different classes of creditors under different resolution strategies and failure scenarios. There is a material level of national discretion and variation in subordination requirements for non-Pillar 1 banks since it falls to national resolution authorities to assess the financial stability risks of domestic banks. Subordination may be achieved through statutory, contractual or structural subordination.

Minimum debt requirements

66. **Two of the featured jurisdictions require a minimum level of long-term debt in the composition of banks' LAC.** This is consistent with the expectation set out in the FSB TLAC Standard that G-SIBs meet at least one third of their minimum TLAC requirement with long-term debt instruments.⁴³ A minimum debt requirement ensures that LAC has not been fully depleted by absorbing losses as a going concern and there is sufficient LAC remaining at the point of failure. In South Africa, the SARB has established a minimum requirement that one third of TLAC must be met with Flac instruments. A similar requirement was set in Hong Kong where no less than one third of the minimum LAC ratios of the resolution entities and material subsidiaries must be met with LAC debt instruments. In the other four featured jurisdictions, a minimum debt requirement was not considered necessary. One national authority noted that such a requirement may reduce the runway period to the point of failure. Another acknowledged a risk that CET1 may have been exhausted at a late stage in a bank's trajectory towards

⁴⁰ For example, building societies (a UK form of mutual) may achieve this outcome through contractual subordination. Currently, there may be exceptions to the general principle on subordination for banks with a partial transfer PRS that assumes that only preferred liabilities will be transferred. However, this consideration will become less relevant when the revised MREL policy for banks with a transfer PRS applies, from 1 January 2026.

⁴¹ Pillar 1 banks comprise resolution entities and material subsidiaries of global systemically important institutions (G-SIIs); banks with total assets above EUR 100 billion; and other banks assessed by their national resolution authority to pose a systemic risk in the event of failure,

⁴² In addition, the subordinated MREL resources must be equal to at least 8% of the Pillar 1 Bank's total liabilities and own funds. The purpose of this target is to ensure that the conditions for access to the Single Resolution Fund can be met. However, the resolution authority may reduce or increase this 8% subordination target on a case by case basis.

⁴³ See Section 6 of the TLAC Term Sheet, penultimate paragraph.

failure but observed that the non-viability decision is a forward-looking assessment that depends on more than a bank's capital ratio.

Retail investor restrictions

67. **Some jurisdictions have imposed restrictions on or deterrents to the issuance of LAC instruments to unsophisticated or retail investors.** While this is not a requirement under the FSB TLAC Standard, limiting exposure to retail investors mitigates the concern that authorities may delay or avoid a bail-in conversion or writedown due to its impact on holders of the instruments and financial stability.⁴⁴ Under Hong Kong's framework, LAC instruments must have a minimum denomination of HKD 2 million⁴⁵ and issuances in Hong Kong are limited to professional investors with a minimum portfolio of HKD 8 million. The LAC rules also require the issuing prospectus to clearly disclose the fact that LAC instruments are complex and high-risk, and regulators in Hong Kong have issued circulars reminding investors of the risk. In South Africa, a minimum denomination, as prescribed by the prudential authority, is required to deter retail investors. However, there are no restrictions on issuance. In the European Union, the Bank Recovery and Resolution Directive II (BRRD II) permits, but does not require, member states to establish minimum denominations and restrict marketing and issuance to certain investors. Accordingly, rules on issuance and marketing of MREL instruments differ across the European Union.⁴⁶ In Canada, there are limited investor pool restrictions⁴⁷ for issuances of regulatory capital instruments and no explicit restrictions on the issuance of other LAC instruments. In the United Kingdom, there are no statutory restrictions specifically on the issuance of MREL instruments to retail investors. However, rules and principles of the UK market regulator, the Financial Conduct Authority, on financial promotions and issuing prospectus disclosure will apply.

Governing law

68. **Bail-in becomes more complex if LAC instruments are subject to a foreign governing law** In those circumstances, a bail-in by the home resolution authority will need to be recognised and enforceable under that foreign law. This cross-border dimension requires mechanisms for the statutory or contractual recognition of actions taken by the home resolution authority. The LAC frameworks of the featured jurisdictions with a statutory bail-in regime permit LAC-eligible instruments subject to both domestic and foreign governing law. However, LAC-eligible instruments issued subject to foreign law must include a provision for the contractual recognition of bail-in, by which the instrument holder agrees to be bound by any reduction of the outstanding amount due or by any conversion or cancellation effected by the exercise of the bail-in power by the home resolution authority. Most jurisdictions (Canada, the European banking union, Hong Kong and the United Kingdom) require the banks issuing LAC to produce

⁴⁴ Investor restrictions support the credibility of LAC and the feasibility of writing it down in resolution. The allocation of losses to retail investors may be politically unpalatable, even if legally and operationally possible. However, a concentration of LAC holdings by other banks or financial sector entities raises the risk of contagion. As with TLAC, this risk is generally minimised through limitations on cross-holdings and requirements for banks to deduct exposures to the LAC instruments of other banks from their own LAC or regulatory capital. This paper does not cover deduction regimes in any further detail.

⁴⁵ Or USD 250,000 or EUR 200,000 if so denominated, or equivalent to HKD 2 million if denominated in any other currency.

⁴⁶ The treatment is different depending on the instrument. Senior preferred instruments can be purchased by any buyer, while restrictions on the marketing of senior unpreferred instruments vary between member states.

⁴⁷ The Limited Recourse Capital Notes (LRCNs) have a restricted investor pool that is limited to institutional investors and are subject to a minimum denomination. LRCNs are recognised as AT1 instruments by OSFI (OSFI (2022)).

an independent legal opinion assuring that the exercise of resolution powers under the framework of the home jurisdiction will be effective and enforceable when the instrument is governed by foreign law.

Section 7 – Observations on the implementation of LAC requirements

69. **In jurisdictions where LAC instruments have already been issued, banks have not faced material problems in placing them.** Overall, to date market capacity has been sufficient to absorb the level of issuance. Nevertheless, some authorities continue to monitor the issuance of those instruments.⁴⁸ In preparation for the launch of the LAC regime for non-G-SIBs, authorities have conducted studies to assess the absorption capacity of the domestic market, in terms of both demand size and time span over which investors may be expected to become familiar with the instrument and sufficiently confident to increase their exposure to it. At the launch of an LAC framework and when setting the parameters for the LAC requirements, authorities have balanced various considerations.

70. **Some authorities have been active in supporting the creation of an investor base that is commensurate to the amount of LAC that banks will need to issue.** Especially when LAC instruments are first offered in the domestic market, authorities have considered it useful to interact with potential investors to better understand how the LAC requirements could be met with instruments that would be appealing to buyers. For instance, the SARB engaged with the investment community before finalising the Flac requirements; accordingly, market surveys conducted around the time of the launch of the Flac framework showed that over 80% of the surveyed domestic funds would be able under their investment mandates to buy these instruments. Those that were not may be able to adjust their mandate to permit them to hold Flac (see World Bank (2020)). Even in more mature markets for LAC instruments, authorities may encourage banks to engage with the investment community to increase their potential interest. For example, through such engagement, certain banks determined that extending the maturity of the instruments could increase the appetite of some types of investor. The HKMA also engages with credit rating agencies to ensure that they understand the resolution framework and the treatment of LAC instruments in resolution.

71. **Issuance abroad tends to be more expensive.** This is especially the case for banks from less developed capital markets, possibly due to a country premium or limited familiarity with the issuing bank. In addition, for issuance abroad the home authorities cannot tailor the LAC requirements to meet investors' preference to the same extent as for the domestic market. An additional complication of foreign issuance is that overseas investors may require the instruments to be subject to a foreign governing law, which may have an impact on enforceability in the event of resolution of the issuing bank (see Section 6). Such complications may be discussed by the issuing banks and the domestic authority in advance, to ensure that the instruments are properly designed if marketed and sold abroad.

72. **Smaller banks may face greater hurdles in placing LAC instruments due to their business and funding models.** Banks that do not have an established history of market issuance may be less familiar to investors, and this may be reflected in a liquidity premium and the perception of higher risk. The need for smaller banks to offer a higher yield, compared with G-SIBs' LAC, has been noted in Hong Kong. It is also a factor in the European banking union and the United Kingdom, where the LAC requirement is of broad scope and some banks without a history of debt capital market access have been required to issue LAC. Where the obstacles to bond issue for some banks is high, there is some evidence

⁴⁸ The SRB publishes a quarterly report, "MREL Dashboard" on issuance of MREL instruments.

that such banks rely on CET1 instruments, which are relatively more expensive. As a counterbalance, the broad scope of MREL eligible instruments may be particularly beneficial for smaller European banks.

Box 3

HKMA support for banks issuing external LAC

The HKMA undertakes structured and intensive engagement with local resolution entities to help them with issuance of external LAC (HKMA (2024a)). This has been challenging for smaller banks without foreign parents. Such banks may have faced the hurdles of lower international market recognition than G-SIBs, a smaller, regionally focused investor base and more limited issuance channels.

The HKMA has engaged closely with banks to develop issuance plans. One potential problem for banks in meeting compliance deadlines is that there are limited issuance windows owing to the existence of blackout periods in the runup to financial announcements when issuance is not possible. Those blackout periods may amount to three or four months a year, and market conditions will need to be suitable during the open window for issuance.

The HKMA also closely monitors market responses and engages with market participants to promote understanding of resolution and LAC instruments. The banks themselves are expected to engage external advisers and step up efforts on marketing activities to broaden the investor base, including in different jurisdictions.

Issuing banks also typically need to obtain credit ratings from specific rating agencies. This may be a demanding and resource-intensive process for new market entrants. The HKMA has conducted outreach with rating agencies to increase their familiarity with LAC instruments and the resolution framework.

Banks planning to issue LAC instruments are expected to conduct a self-assessment to confirm that the instruments meet the qualifying criteria for LAC debt instrument (HKMA (2024a)). As part of the process, the bank is expected to seek an independent legal opinion. The completed self-assessment, relevant legal opinions and a letter from the Chief Financial Officer (or another person with an equivalent role and seniority) confirming that the proposed instruments comply with the LAC rules are submitted to the HKMA. Once any possible follow-up is resolved, the HKMA will communicate an acknowledgement of the confirmation. In the HKMA's experience, the self-assessment has proved an effective process for the bank to ensure compliance of the terms of the proposed instrument to be issued with the applicable qualifying criteria. It has also been observed to foster investor confidence in the instruments issued to market.

73. **Authorities have been flexible in setting the implementation periods for banks to comply with LAC requirements.** All featured jurisdictions have allowed a relatively extended period for banks to meet their LAC requirements from the moment they first apply. For example, APRA and the SARB have allowed a staggered build-up over four and six years, respectively. In Hong Kong, once a bank is classified as a resolution entity or a material subsidiary, it needs to meet LAC requirements within two years. However, the HKMA has flexibility to extend that period if satisfied that it is prudent to do so. Similarly, the SRB can tailor the issuance period to accommodate challenges in market access that may affect the ability of individual banks to issue LAC instruments that meet subordination requirements. Authorities also use intermediate LAC targets as staged implementation before banks are required to meet the final target: these may vary between banks, reflecting each bank's starting point.⁴⁹ Moreover, all authorities interviewed monitor market conditions, and in most cases⁵⁰ they can adjust the implementation timeline of the LAC build-up against adverse market conditions. This was evident at the time of 2023 banking turmoil when banks faced reduced market appetite for LAC instruments, and issuance was allowed to slow.

⁴⁹ For instance, in the European banking union, cross-bank differences may depend on the shortfall against the final target and any applicable Pillar 1 subordinated MREL requirements.

⁵⁰ Such flexibility does not apply to all jurisdictions. In Canada, full compliance was required in 2021.

74. **Authorities may also support banks in increasing their familiarity with the market and LAC issuance.** Although it is the responsibility of each bank to take the necessary action to meet its LAC target, some authorities support banks with issuance planning. In the United Kingdom, the supervisor and resolution authority seek to engage with smaller banks in advance of their being required to meet MREL targets. For firms coming into scope of MREL, this includes a notice period of up to three years and a subsequent “glide path” to end-state MREL that is ordinarily six years. This firm-specific engagement is forward-looking and anticipates growth that is expected to lead to a change in the firm’s PRS. A proactive approach is also taken in Hong Kong (Box 3), and the HKMA aims to continue working closely with relevant firms on their build-up and maintenance of LAC resources in a prudent and proportionate manner, taking into account international experience and evolving economic and market conditions (HKMA (2024a)).

Section 8 – Conclusions

75. **The 2023 banking turmoil demonstrated that even banks not identified as systemically important or critical may give rise to contagion and disrupt financial stability if they fail.** The lessons drawn from those events include the importance of ensuring that systemic banks other than G-SIBs can be resolved in an orderly manner without exposing taxpayers to loss from solvency support. Funding is therefore a key factor in orderly resolution, and resolution preparedness includes ensuring that the necessary funding will be available when a systemic bank fails.

76. **Funding for bank failure management can come from a range of sources.** One source is LAC. LAC in excess of MCR increases authorities’ options for resolving a bank. Other sources include industry-funded arrangements such as deposit insurance and resolution funds. LAC pushes the costs of managing a bank’s failure to its shareholders and creditors. Industry-sourced funding mutualises costs across the banking sector. There is also the possibility of exceptional public solvency support. This channels costs to taxpayers, although they may ultimately be recovered from the industry.

77. **The balance between these possible sources of funding is a policy decision for jurisdictions based on their institutional framework and the structure of the banking sector.** LAC ensures that a large part of losses and costs of resolving a failed bank are internalised and should provide predictability about how they will be allocated to holders of LAC instruments. However, the existence of a resolution fund or well-resourced deposit insurance fund lessens the need for exclusive reliance on banks’ internal resources and may reflect a decision to mutualise some of the costs of resolving individual institutions. A greater role for industry-funded arrangements could, for example, be a pragmatic response to higher costs for smaller banks of building up LAC that may result from a market perception of higher risk or a liquidity premium. LAC requirements for such banks could be lower if alternative sources are available, provided that access to that funding is not limited by onerous conditions.

78. **Additional LAC offers advantages as a reliable source of resolution funding, and there may be sound policy reasons for extending requirements beyond G-SIBs to other systemic banks.** The initial restriction of a LAC standard to G-SIBs was justified by their cross-border nature and their comparability as a group relative to other banks. However, systemic instability in the banking sector can originate from banks other than G-SIBs. Such banks need to be resolvable if their failure could have systemic impact. Funding is a key aspect of resolvability and a wider scope of LAC requirements reflects the risks their failure could present.

79. **Nevertheless, designing and implementing LAC requirements entails challenges.** The design of LAC frameworks needs take into account the nature of the domestic banking sector, the banks’ characteristics and the available market for LAC instruments. As demonstrated by the various approaches adopted in the featured jurisdictions, there are different ways of tailoring the scope to cover banks that

are systemic for the domestic market in a way that is appropriate to the applicable resolution framework. While under some frameworks LAC requirements are limited to D-SIBs or other designated systemic banks that will be subject to a bail-in resolution strategy, in others LAC requirements also apply to banks with a transfer PRS. This has the advantage of expanding the scope of business that may be transferred (before needing to draw on other sources such as a deposit insurance or resolution fund). However, this may also bring a more diverse set of banks within the scope of the LAC requirement, including banks that have not traditionally issued significant volumes of debt.

80. **This suggests a trade-off between the scope of LAC requirements and the nature of the instruments that are eligible to meet it.** If the costs of debt issuance or other structural obstacles induce some banks to meet LAC requirements largely or exclusively with CET1, authorities need to consider the risk that CET1 will be largely depleted at the point of failure. Subordinated, long-term debt may constitute a more reliable source of loss absorbency and recapitalisation capacity in resolution, but this is weighed against issuance costs across the cohort of banks that are subject to LAC requirements, their access to international markets and the capacity of local markets to absorb it.

81. **Moreover, the calibration of LAC requirements needs to navigate a trade-off between tailoring and simplicity.** The more LAC calibration is tailored to the individual bank, the greater the risk of complexity. The diversity in banks' business models, PRS and the operating environment imply that LAC requirements need to be able to accommodate bank-specific features. However, a high degree of tailoring may reduce the transparency and predictability of the framework. A more complex, more judgment-based, determination of bank-specific levels of LAC as part of the resolvability assessment is also burdensome for resolution authorities and possibly increases their exposure to challenge.

82. **It is valid to consider how far LAC requirements could be streamlined or simplified, without impairing their ability to support orderly resolution without reliance on public funds.** A simpler, more straightforward LAC framework that calibrates the LAC requirements with consistency and transparency can deliver sufficient levels of LAC to facilitate resolution. It is not possible to calibrate LAC requirements for individual institutions with scientific precision, and there may be advantages in terms of simplicity in a less tailored approach, even if that could require authorities to calibrate requirements conservatively.

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