A response to the Bank of England's Discussion Paper on its

approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

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Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms, we act to enhance competitiveness, support customers and facilitate innovation.

We are pleased to respond to The Bank of England's Discussion Paper (DP) reviewing its approach to setting a minimum requirement for own funds and eligible liabilities (MREL). This UK Finance response to the Bank's DP has been informed by extensive discussions with members, particularly those banks and building societies (which we collectively refer to as 'banks' herein) that are at the point of being required to hold MREL because they are about to cross either the transaction account threshold or the balance sheet size threshold. We look forward to working with the Bank of England as it reviews and refines its approach to MREL to reflect changes in the UK's banking market since it was first designed in 2015.

Key messages

Our members support the objectives of resolution

The resolution framework introduced by the Banking Recovery and Resolution Directive, which was adopted in the spring of 2014, introduced the requirement for some banks to hold additional amounts of MREL in the EU based on, but not fully aligned with, the Financial Stability Board's (FSB) Total Loss Absorbing Capacity (TLAC) standards finalised in November 2015. The MREL component of resolution framework provides a mechanism for dealing with failing banks by ensuring that those subject to a partial transfer or bail-in resolution strategy have sufficient capacity to absorb losses avoiding the need for the injecting of public sector funds. Our members support the overarching rationale of the MREL regime and objectives of the Resolution Authority's approach which seeks to ensure the risks to depositors, the financial system and to public finances that could arise due to the failure of a bank are reduced.

But MREL needs to change

The design of the UK's MREL framework has increased in complexity over the years and has a number of shortcomings, including:

- Cliff edge effects which require significant increases in capital the moment one or other threshold is breached
- A consequent curtailment of mid-tier banks' ability to compete, limiting customer choice and innovation
- A complicated and interconnected prudential regulatory regime that obfuscates investor understanding of the pathway to MREL
- Uncertain investor appetite for mid-tier bank MREL debt instruments arising from the complexity of the MREL approach and the consequent elevated 'carry cost' and related impact on business models and growth.

The resolution toolbox is comprehensive

MREL is now complemented by a range of other resolution tools, that have been introduced since the Bank first consulted on the design of MREL in late 2015.The additional levers that they provide, including complementary tools such as continuity of access, solvent wind-down and valuations-in-resolution, should be used by the PRA and Resolution Authority, working in unison to ensure synergies are captured, understood and taken into account as a more proportionate, risk sensitive MREL regime is developed.

Current thresholds are no longer relevant and hold back competition

There is now a much wider range of internet banking based quasi current account products available to retail customers than when the *transaction account* definition was first created. Many individuals now have more than one account with product features that result in it being characterised as a transaction account for MREL purposes, although customers would not be materially inconvenienced, were one of them to be temporarily inaccessible, because of the greater portability of these accounts. There is no longer a rationale for a transaction account test of any size, and we suggest this test be removed. Should it still be considered necessary that a concept similar to transaction account be needed, a revised definition of 'primary transaction account' should be introduced to reflect changes in the nature of customers' use of current accounts, reducing the number of in-scope accounts to only those which are critical for day-to day financial life.

The *asset size* threshold is a real dampener on mid-tier banks' growth plans and should be refined now a wider range of tools is available to ensure that all banks can fail without threatening financial stability or individuals' access to critical economic functions. It should be benchmarked to total assets less central bank deposits, aligned with the FPC leverage definition, as a better and more consistent indicator of the criticality of a bank's activities for their customers and the risks posed by a bank to the FSCS and taxpayers.

It is time to rethink the MREL regime

The complexity of MREL framework is a deterrent for investors who have become less willing to invest the time necessary to understand it deeply. It is noticeable that the Bank's recently posted updated indicative MREL requirements are very hard to reconcile back to previous indicative requirements and figures disclosed by the firms themselves. This opacity has increased the cost of capital for UK banks and particularly the cost of MREL qualifying debt instruments for mid-tier banks.

The DP provides an important opportunity to take stock and consider the extent to which the Bank's MREL regime meets its original objectives and remains correctly calibrated, as well as its potential impact on the longer-term resilience and competitiveness of the UK's banking system. We very much welcome this review and encourage the Bank to think more broadly than just a reassessment of the levels at which thresholds are set, considering more exciting possibilities for reform, which could include:

- **removal of the transaction account limit entirety, or failing that a more targeted primary transaction account definition**
- **a graduated increase in MREL requirements as a firm enters the MREL range, which we suggest should be increased to £25bn – £50 bn of total assets**
- **excluding central bank deposits from the Total Asset measure**
- **an extension to the 36-month period in which a bank should issue MREL to five years**
- **for leverage constrained firms, basing the Loss Absorption requirement on risk weighted assets**
- **a more nuanced setting of the required Recapitalisation Amount, based on the PRA and a bank's own assessment of its resolvability**
- **internal MREL investments in own funds and eligible liabilities which are deducted should be excluded from the leverage exposure measure**
- **the internal MREL scalar should be set in the range 75 -90%**
- **clarification of the 'incentives to redeem'**
- **greater intra Bank of England cooperation and utilisation of the now wider range of resolution tools**
- **regular periodic reviews of the MREL regime based on increases in inflation/size of the economy, practical experience of deploying resolution**

We look forward to working with the Bank to develop these suggestions.

To facilitate this, we respond to the questions asked in the DP below.

1.Are there any issues or evidence that respondents would like to bring to the Bank's attention that would inform its review of the MREL framework, in particular relating to the thresholds for resolution strategies, the calibration of the requirements, the eligibility of instruments or the application of MREL within banking groups?

Competition in and building back better

An efficient, innovative and competitive financial services sector is critical to the future growth and prosperity of the UK economy. It also increases customer choice. Now there is a pressing need to harness all segments of an already highly competitive UK banking market to build back better, as our economy emerges from the financial stresses caused to many households and businesses by the Covid pandemic and our economy builds back better.

A strong mid-tier can support these objectives by providing greater competition and consumer choice in the current account, savings and lending markets. They have diverse, scalable business models, which help them serve the financial needs of a wide range of customers and provide much needed plurality in the provision of financial services. Many have strong physical presence in regional areas serving the needs of local customers. This part of the market is also well positioned to help small businesses, by virtue of their focus on this segment and their personalised underwriting and service. But the current approach to MREL penalises growth by mid-tier banks and discourages the entry of new businesses.

A number of recent market developments, such as better consumer transparency and comparison services, the current account switching service and wider sharing of credit data and other customer dynamics through open banking will support mid-tier banks in providing this competition. These banks also provide capacity within the system for customers to rapidly establish alternative bank accounts in the event of the failure of another bank. but as a group they are being held back by the design of the MREL regime. Requiring the Resolution Authority to have regard to the competitive implications of its decisions in relation to individual banks and the overall design of the regime would help improve this situation and would enable mid-tier banks to play their full part in the supporting their customers in building back better.

Proportionality - moderating the Recapitalisation amount

We support a flexible and proportionate MREL regime, where a Pillar 1 minimum requirement satisfying FSB requirements is supplemented by a bank-specific Pillar 2 requirement that is determined on a case-by-case basis and takes into account the specific features and risk profile of the individual bank, as well as size. This would give the Resolution Authority the full ability to adjust elements of the calibration of the Recapitalisation Amount (RA) based on its assessment of the bank and could be supported by the bank's own Valuation 3 assessment.

The assessment of MREL RA requirement for an individual bank would therefore be based on a firm specific view in terms of size and/or business model. For instance, many newer banks' business models rely on an outsourced current account provider. Where they do so it is likely that these current accounts could be transferred to another bank relatively easily and this portability could be taken into account.

A comprehensive re-assessment may suggest that there is no need at all for MREL over and above the LA amount unless the bank has been identified as being subject to a bail-in resolution strategy. Experience of partial transfer in other parts of the world suggest this resolution strategy can be achieved without extra MREL being required, necessary incremental funding often being provided by the acquiring institution

We note that the Bank will adjust *"MREL downwards for institutions with a partial transfer resolution strategy, to reflect the proportion of the balance sheet that would be transferred under the resolution strategy"*. But lack of clarity about how this moderation process works tends to mean that investors anticipate that RA will match the Loss Absorption (LA) amount, even though in most cases covered deposits and associated assets can be easily transferred and the RA can be thought as being akin to the working capital need to achieve this.

The Resolvability Assessment framework (RAF), including Valuations in Resolution (or alternatively the Pillar 2B requirement) could be used to provide the assessment of the ease of resolvability of a particular bank which would moderate the RA requirement. It could be that extension of the RAF and publication by the PRA of its bank specific resolvability assessment could assist investors in understanding where on the continuum of resolvability of a particular bank sat, although we recognise that this potentially introduces other issues for banks that have a lower quartile score. We note too that the techniques used in Valuation 3 are analogous to those used by investors to assess value. We look forward to working with the Bank to explore the pros and cons of this idea and indeed if the MREL requirements should only apply at all to PRA category 1 & 2 firms or those classified as G-SIBs or O-SIIs.

The Leverage Ratio problem

The Leverage Ratio (LR) tends to become the binding constraint for building societies under the IRB approach. Although this penalises their low risk, mortgage-centric model, regulators have suggested that the IRB risk weights may not capture the 'true' risk of the underlying assets, and therefore a minimum LR provides additional 'guard rail' protection. Correcting this perception of incomplete risk coverage was a key objective in the development of the Basel 3.1 framework which will be introduced at the beginning of 2023 as well as the possible introduction of mortgage floors, which we do not support.

The impact on this for building societies is compounded for MREL, which is set at two times the leverage ratio (for non-G-SIBs). As an example, for a building society with an average IRB risk weight of 12 per cent and minimum leverage ratio, including buffers, of 3.60 per cent, the minimum Tier 1 capital is 30 per cent of RWAs and the total MREL is 60 per cent of RWAs. This compares to an average 2022 MREL of 27.7 per cent for the UK's systemically important banks, excluding Nationwide (for which MREL is set based on the leverage ratio).

A route to solving the Leverage Ratio problem

In the absence of an increase in thresholds an alternative route to solving the leverage ratio problem would be to refine calibration of the LR MREL requirement. Members accept the underlying logic of setting MREL based on a Loss Absorption (Pillar 1 plus Pillar 2A) and Recapitalisation amount. Having a RA based on binding LR or RW capital is accepted, but members using the IRB approach whose MREL requirement is determined by the Leverage Ratio question if the LA amount needs the same amount given the built-in conservatism of this unmodelled approach? Banks are trusted to have the required sophistication to set their own loss-absorbing capital (i.e. through IRB or replacement capital floors) - they should be permitted to use this number to calculate the LA amount. This would result in MREL LR set at RWA + LR, not 2xLR with its associated deadweight cost.

Exempting central bank exposures

The Bank's MREL policy requires firms to meet an end-state MREL requirement based on the leverage exposure measure of the higher of two times the applicable leverage ratio requirement or 6.75% of leverage exposures. In addition, the FSB Pillar 1 TLAC requirement in Article 92a of CRR (as onshored) imposes a similar requirement, albeit one where the leverage exposure calculation does not benefit from an exemption for central bank exposures (as this still applies the CRR definition of the leverage exposure measure). Leverage exposure for the purposes of the Bank's LR MREL policy requirement is calculated on the same basis as the PRA's leverage ratio requirement. The current PRA policy on the leverage ratio allows firms to exclude from the leverage ratio exposure measure central bank claims matched by deposits in the same currency, provided the date of contractual maturity of the central bank claim is the same as, or is before, the date of contractual maturity of the deposit. The leverage ratio requirement has been adjusted upwards to 3.25% in the PRA policy to reflect the exemption of central bank exposures.

We would urge the PRA to enshrine a single MREL/TLAC regime in its rules, rather than having the dual structure of a Pillar 1 TLAC requirement in the onshored CRR and the MREL requirement in the Bank's MREL policy. This can be done as part of the project to recast onshored EU financial services legislation as PRA rules. The PRA's policy on exempting central bank exposures should be applied both for the purposes of the Bank's MREL policy and in calculating the leverage exposure measure for the purposes of the FSB TLAC minimum requirement, as set out in Article 92a of the CRR (as onshored). The PRA should retain its existing central bank exposure exemption policy and it should not be aligned with the provisions of CRR2 on exempting central bank exposures from leverage exposure. The PRA's policy on exempting central bank exposures is consistent with the Basel Committee on Banking Supervision's (BCBS) final standard on the leverage ratio.

There are very strong policy reasons for exemption of central bank exposures in the current macroeconomic environment where central banks have engaged in unprecedented action to support economies in the face of the pandemic. As the BCBS has pointed out:

> *"In the aggregate … banks have no choice but to absorb the targeted level of reserves. … the question is whether there are exceptional situations in which banks would refrain from subscribing to fund-supplying operations because concerns over the [leverage ratio] impact of the reserves that would be added to the banking system in aggregate outweigh the financial benefits accrued by participating in the operations. If so, this lack of participation could prevent a central bank whose operating framework entailed increasing the quantity of reserves from meeting its operating target. … when the central bank expands reserves by a large amount (for example, to meet increased demand for reserves during a period of financial stress or to stimulate the economy), the [leverage ratio] constraint is more likely to bind, which may require more of an adjustment of bank balance sheets."*

It was for this reason that the UK took the lead amongst major economies to exempt central bank exposures from the leverage ratio exposure measure. As the July 2016 Financial Stability Report pointed out, central bank reserves are a unique asset class because they are the ultimate settlement asset. If matched by liabilities in the same currency, they typically do not represent an 'exposure' to risk. Therefore, there is no direct benefit to funding holdings of reserves with capital:

> *“[I]n circumstances where central bank balance sheets expand (for example, through increased use of liquidity facilities), regulatory leverage requirements can effectively tighten. … This could act as a disincentive to access central bank liquidity facilities. It could also prompt banks to* ***deleverage by shedding assets, cutting their supply of credit, or withdrawing from other activities, including support for market functioning****. These effects would take place at precisely the same time the central bank is aiming to support market functioning and economic activity.” (emphasis added)*

In ordinary economic conditions, there is no need to exempt central bank reserves from the exposure measure, as banks’ holdings will typically be a small percentage of their overall asset portfolio. However, in the unusual macroeconomic conditions since the 2008-09 financial crisis (which have been exacerbated by the pandemic), where central banks have expanded their balance sheets on a large scale, reserves have come to constitute a significant portion of banks’ assets, to the extent that the LR is beginning to turn into a binding constraint for many banks. So we recommend that the total asset test is set net of central bank deposits and, as we note below, internal MREL.

Deduction of internal MREL

In the application of MREL within banking groups, the industry continues to face inconsistencies in the rules about internal MREL deduction and calculation of the MREL requirements. In short where a parent entity and its subsidiary are both required to calculate MREL requirements and the subsidiary’s MREL instruments are issued to the parent, there is a double count of MREL at the parent level where exposures which are deducted from MREL resources continue to be included in the requirement calculation as risk-weighted assets or leverage exposures.

Generally, MREL requirements are calculated based on the higher of the RWAs or leverage exposure measures. The Bank stipulates in its Statement of Policy on Internal MREL point 7.14 that entities should not double count resources required to meet their MREL. Therefore, in a scenario where a firm holds MREL investments in other entities within the group, those investments will be deducted from the MREL resources to avoid double counting. The leverage exposure measure or the RWA of the entity however will not be adjusted to remove those exposures. This is because of a gap in the rules which do not foresee similar adjustments available within the capital framework (UK CRR Article 113) and leverage frameworks (CRR Article 429(4)(a)).

This point was included in responses to the Bank of England’s consultation on its Statement of Policy on Internal MREL in 2018 and acknowledged in paragraph 3.10 of the feedback to the industry.

> [3.10 *“Some respondents also asked whether investments in internal MREL will be deducted from RWAs and leverage exposures, in line with the FSB’s Principles. The Bank notes that this treatment already applies to own funds instruments, where there are deductions for investments in own funds instruments of subsidiaries. The RWA and leverage treatment of investments in internal MREL eligible liabilities may be affected by the outcome of EU negotiations to update the EU prudential and resolution frameworks and the Bank will continue to engage with the PRA on this issue.”]*

However, changes have not yet been reflected in the framework.

The proposal is consistent at the international level as evidenced by the Financial Stability Board guidance in its international standards on internal TLAC which allows for investments in internal TLAC subject to deduction to be deducted from the RWAs and leverage exposures.

The issue was recently highlighted by the EBA in a letter to the European Commission, where this gap in the rules has prevented the EBA's finalisation of the RTS on daisy chains as mandated under BRRD[1].

It is recommended that consideration be given to updating the rules such that for the purposes of calculating the MREL requirement, internal MREL investments in own funds and eligible liabilities which are deducted should be excluded both from the risk weighted exposure amount and leverage exposure measure.

internal MREL scalars

We also note that CRR Article 92b requires the internal MREL scalar to be set at 90% whereas the Bank's 2018 Statement of Policy would set internal MREL in the 75% - 95% range, which is in line with paragraph 19 of the FSB's international standard. We would prefer internal MREL to be set within this range, rather than automatically at the top of it.

Basel 3.1 and risk weighting

Banks currently on the Standardised Approach tend to need to hold significantly more capital against credit risk than those on IRB. Stepping over the MREL threshold would amplify this additional capital requirement by effectively doubling a bank's MREL requirements to two times the minimum capital requirement. There is therefore a significant risk that standardised banks will be required to issue MREL for what could be only a short-term requirement prior to achieving IRB accreditation. This risk is heightened further by the significant uncertainty over how PRA will adopt the revised Basel 3.1 standardised approach from 1 Jan 2023, particularly in respect of buy to let lending portfolios, which could significantly impact minimum capital requirements for standardised banks.

The remedy for this issue is longer transition periods for standardised firms but also other proposals discussed in this paper such as re-calibrating the basis for MREL setting

2. Does the discussion in Section 2 capture all relevant potential impacts of the entry into insolvency of a bank which meets the current indicative thresholds? If not, what other impacts should be considered?

As we note above and below the mechanisms for dealing with a failing bank have evolved significantly since the underlying structure of the UK's current approach to MREL was established in 2015. For instance the Continuity of Access rules are a mechanism which reduces the risk of customer detriment in the event of a bank with many transaction accounts failing. This newer requirement protects transactional account customers and would continue to have effect regardless of the level at which the balance sheet size threshold for full bail-in is set. So the transaction account threshold could either be removed - our preference - or increased without introducing further risk. This argument is also supported by the fact that majority of mid-tier firms do not provide any critical financial market infrastructure, reducing systemic impacts under insolvency compared to

[1] https://www.eba.europa.eu/sites/default/documents/files/document_library/About%20Us/Missions%20and%20tasks/Correspondence%20with%20EU%20institutions/2021/962427/2021%2001%2025%20Letter%20to%20J%20Berrigan%20re%20Art%2045f%286%29%20BRRD%20%28daisy%20chains%29.pdf)

the largest MREL banks. Furthermore Payment Service Providers, who also provide transaction accounts to retail customers have no requirement to hold MREL.

3. Does the discussion in Section 3 accurately reflect the experience of banks in issuing MREL instruments? If not, please set out your perspective on banks' issuance.

The cost of MREL

The sterling debt capital markets have not worked well for mid-tier banks seeking to raise MREL. The table below shows the issuance costs of different banks.

	Issue Date	Spread (G+, bps)						
		Current spread	Spread at issue	Min spread	Max spread	Trading range	10-90 percentile range	Interquartile range
			Metro Bank					
MTROLN 9.5 Oct-24 / Oct-25	Oct-19	1,396	922	679	1,932	1,253	1,076	823
			VMUK					
VMUKLN 3.125 Jun-24 / Jun-25	Jun-17	161	250	151	515	363	197	121
VMUKLN 3.375 Apr-25 / Apr-26	Apr-18	169	208	168	529	361	165	120
VMUKLN 4 Sep-25 / Sep-26	Sep-18	167	280	166	556	390	218	87
VMUKLN 4 Sep-26 / Sep-27	Sep-19	168	375	167	540	373	249	154
Average		*166*	*278*	*163*	*535*	*372*	*207*	*121*
			UK Incumbents					
HSBC 2.256 Nov-25 / Nov-26	Nov-17	102	120	95	364	269	89	37
BACR 3.125 - / Jan-24	Jan-17	88	210	87	419	332	107	51
LLOYDS 2.25 - / Oct-24	Oct-17	88	135	84	340	256	95	44
NWG 2.875 Sep-25 / Sep-26	Mar-18	109	170	103	398	295	110	46
SANUK 3.625 - / Jan-26	Jan-16	108	187	108	333	225	103	60
Average		*99*	*164*	*95*	*371*	*275*	*101*	*47*
VMUK/Incumbents multiple		*1.7x*	*1.7x*	*1.7x*	*1.4x*	*1.3x*	*2.1x*	*2.5x*

Requiring banks to raise expensive MREL debt, effectively making a mid-tier bank a "forced seller", because the funding need arises from an inflexible regulatory requirement, creates both a capacity issue (investors may not have sufficient demand for a new name) and potentially also a significant cost issue. The upfront costs of raising MREL capital instruments as they fall over the cliff's edge are higher for smaller institutions, an effect that is exacerbated by the likely smaller size of their MREL issuances. Alternatively to optimise coupon and issuance costs banks may issue larger amounts than required, leading to a significant cost-of-carry, because of the difference between the high coupon cost and the rate achievable in the lending markets, yields on HQLA or the low Bank Rate received in placing funds on overnight deposit at the Bank.

As an example, Tesco Bank issued £250m of MREL qualifying bonds in July 2019 at Gilts plus 305bps which represented a cost of funds premium of about 230bps compared to an ABS funding transaction of similar maturity. The bond priced 100-105bps higher than equivalent HSBC and Barclays bonds issued a little earlier in May 2019. This demonstrates the competitive funding disadvantage faced by mid-tier firms subject to an MREL requirement.

A pooled facility?

Smaller banks without the need for a rolling programme of MREL issuance also face refinancing risk. It is likely that their preferred strategy would be to delay refinancing until very close to the maturity of an existing MREL instrument, leaving them at risk from the vagaries of the market.

Rather than each individual bank issuing or refinancing its required MREL in the open market we propose that the concept of a pooled facility should be explored, based on a part funded/part unfunded 'insurance' model.

A pool of MREL 'capacity' would be built up over a short period of years with participants paying 'insurance' premiums on a risk adjusted basis. These would be higher in the early years of a bank's membership of the pooled scheme and also higher depending, for instance, on its risk weight density or other measure of riskiness, such as its resolvability assessment score. This risk sensitivity would also encourage a programme of continuous improvement of risk management and governance processes.

Incentives to redeem

We note that the Bank's MREL policy paper states that it:

> *"expects institutions not to structure their MREL eligible liabilities in such a way as to reduce their effective maturity, for example liabilities which create incentives for the issuer to redeem them ahead of the contractual maturity date. An increase in the interest rate payable on a liability (a 'step up') coinciding with an issuer call option is an example of an incentive to redeem in this context. Where liabilities do include such an incentive, the maturity date of the liability shall, for the purposes of determining whether it is an MREL eligible liability, be considered to be the date at which the incentive arises."*

We would welcome clarification of the practical implications of this requirement. The effect of this expectation is that any tap of the existing MREL bond would be priced at the time of issue and hence carry a different spread to the original bond. Whilst this is not problematic in itself, or from an investor's perspective, where the spread on the tap tranche of the bond is lower than the original spread it creates a theoretical economic rationale for the issuer to "call" the original tranche of the bond on its contractual reset date i.e. one year prior to contractual maturity. This economic rationale is described here as theoretical because in the case of a bank tapping an MREL bond to ensure/maintain compliance with an ongoing MREL requirement makes the calling of any tranche of the bond redundant. Both tranches of the bond would only be called at the contractual call date when the bond ceases to qualify as MREL eligible.

The result of this could be to consider that the spread differential on the two tranches of the bond would represent an "incentive to redeem" with the result that the eligibility of both tranches of the bond for MREL purposes would be foreshortened by a further year (the economic incentive arising on the reset date of the bond). This would leave the bank with an elevated cost of funds on the entirety of the tapped bond for an additional year with no MREL qualification benefit.

Conversely in a situation where the tap tranche of the bond was issued at a higher spread there would be no economic "incentive to redeem" and it is this asymmetry as well as the fact that the issuer would not rationally seek to redeem an MREL bond ahead of its contractual call (for reasons of maintaining regulatory compliance) that creates the problem. The ability to tap callable bonds is critical especially for less frequent issuers as:

- Issue costs are reduced as there is no need to prepare new documentation;
- New issue premia in taps are typically less than the cost of a standalone issuance;
- The issuer's MREL needs may not be of a size which warrants a new issue (anything less than £250m or €500m could be seen as 'illiquid') and could be much better met by tapping

So we believe the onus on issuers not to create incentives to redeem should be limited to the situation prevailing at the time of the new issue; prevailing spreads at the time of the tap are not within the control of the issuer and issuers will not necessarily always opt to only tap bonds which have tightened in spread so in that sense tap issues are not designed to circumvent 'the incentive to redeem' requirements.

So a clarification of the Bank's policy is this regard would be welcome.

4. Does the discussion in Section 4 capture all of the regulatory developments relevant to MREL? If not, which other regulatory developments are relevant to the Bank's review of MREL policy.

MREL is complemented by a range of other tools, that have been introduced since the Bank first consulted on the design of MREL in late 2015, which should be taken into account as the MREL regime is reviewed. In particular, UK banks, unlike EU banks, are subject to the ring-fencing regime, including higher MREL pre-positioning requirements in respect of ring-fenced subgroups. The current UK MREL framework does not take into account the material enhancements to resolvability that flow from the implementation of the ring-fencing regime.

Greater intra institutional cooperation

These tools are currently deployed variously by the Resolution Authority and the PRA, resulting in a siloed and bifurcated approach. Greater intra Bank liaison and cooperation would create a more joined up approach to resolution and the setting of MREL, reduce duplication for our members and importantly increase institutional and political confidence about the resolvability of a particular institution.

Using the range of tools to set a firm specific MREL requirement

It is not clear that an appropriate and proportionate risk-based assessment has been made when bringing mid-tier firms into scope for the entire suite of MREL, Recovery & Resolution, Valuation in Resolution and OCIR standards. These include the requirement for banks to submit resolution packs containing information to enable the authorities to prepare for orderly resolution of a failing bank, the development of the Resolvability Assessment Framework, solvent wind-down the possible future disclosure of the Bank's assessment of a bank's resolvability, Operational Continuity in Resolution (OCIR) and continuity of access requirements, the calculation of RWAs, (which determines the Loss Absorption amount) and reverse stress testing. These requirements represent a significant additional burden for mid-tier firms – so their outputs should be taken into account in setting a more risk adjusted MREL requirement.

5. What are your views on the Bank's current graduated approach to 'growing into MREL' and in particular, the provision of a transition period of at least three years? The experience of some mid-tier banks in issuing MREL instruments suggests that this period may be insufficient for them to establish themselves as issuers of those instruments. The Bank would particularly welcome public comments on this point.

Growing into MREL

For banks which are growing rapidly, post authorisation, it can be difficult to obtain the credit rating required to issue MREL in the public markets. *Inter alia* this makes raising of MREL capital instruments inherently more expensive for smaller banks by virtue of their size, less established track record and lack of debt market exposure. Alternative issuance, in the private markets, is likely to prove even more costly. We welcome the Bank's acknowledgment of this in Section 3 and the 'growing into MREL' approach which allows banks up to 36 months to have completed their required MREL issuance, which somewhat mitigates this challenge

Whilst 36 months may seem generous banks will balance the cost of carry of raising high coupon MREL early with the risk that the public wholesale debt capital markets may be closed as the end of the second-year approaches.

So we recommend that the current 36 month period within which a bank is expected to issue MREL be increased to five years, to allow a bank to build an 'MREL-investable' investor profile based on the need to establish a three year track record before approaching rating agencies followed by a further two years to bring the issue to market. This would also ease the impact of higher funding cost on business model planning, increasing the likelihood that the financial benefit of planned growth would be retained given the incremental cost of resultant MREL.

The asset size threshold

As mid-tier banks grow in size, they face a number of cliff-edge regulatory requirements, which currently are set at various thresholds. Currently the MREL threshold is based either on a £15 billion – £25 billion of range assets for 'bail-in' or more than 40,000-80,000 transactional accounts, and less than £15 billion – £25 billion of assets for 'partial transfer'. In contrast the current ring-fencing threshold is a three-year average of more than £25 billion 'core' deposits, broadly defined as all deposits other than those from non-bank financial institutions and the Leverage Ratio threshold is set at £50bn of core deposits. So, banks and their investors have a range of different thresholds to keep in mind which adds to complexity to balance sheet management and analysis.

It is our view that the MREL total asset thresholds are set at levels that are low compared to the systemic risk of these institutions pose and should be increased to mirror existing thresholds in other parts of the prudential regulatory regime.

The table below compares some of the thresholds used in the Bank's regulatory material.

Examples	Firms captured
Stress Testing (ACS/BES)	*£50bn + of retail deposits*
3.25% leverage ratio	*£50bn + of retail deposits*
Written Audit Reports	*£50bn + of assets*
Systemic Capital Buffers	*£175bn + of assets*
Remuneration	*Proportionality level 1 (> £50bn assets), Proportionality level 2 (>£15bn to 50bn), Proportionality level 3 (< 15bn assets)*
Senior Managers Regime	*Simplified SMR for firms less than £250mn*
Structural Reform	*£25bn core deposits for ring fencing*
MREL	*Bail-in (15bn – 25bn assets) , partial transfer (40k – 80k transactional accounts)*
RAF Disclosure requirements	*£50bn + of retail deposits*
Stress-testing data reporting	*£5bn + of assets*
Capital + reporting	*£5bn + of assets*
Refinements to Pillar 2A	*Firms on standardised approach*

We would be delighted to discuss further with the Bank at which levels thresholds should be set and against what reference set, total assets[2] (still our preferred choice), covered deposits or core deposits

A sliding scale to replace the step-up from one to two times MREL requirements

The doubling of the MREL requirement as a bank transitions from an insolvency resolution strategy to a bail-in resolution strategy is significant.

The Independent Commission on Banking Final Report recommended that the primary loss-absorbing capacity be set on a sliding scale to the ratio of RWA to UK GDP:

> *"UK G-SIBs with a G-SIB surcharge below 2.5 per cent and ring-fenced banks with a ratio of RWAs to UK GDP of in between one per cent and three per cent should be required to have primary loss-absorbing capacity set by a sliding scale from 10.5 per cent to 17 per cent of RWAs",*

With the UK GDP at c.£2 trillion, this would suggest a range of RWAs between £20 billion and £60 billion for the one per cent to three per cent GDP range, or, assuming an average risk weight of 25 per cent, a range of assets between £100 billion and £240 billion.

We too recommend that the MREL threshold be revised and MREL requirements be introduced on a sliding straight-line scale from 1 times MREL to 2 times MREL as asset size increases from, say, £25 billion to £50 billion of total assets excluding central bank deposits. Most importantly for our members this staged approach this would overcome the sudden and dramatic cliff-edge of the jump to two times the LA amount when a bank's balance sheet exceeds, even by a very small amount, the current £15 billion asset size threshold. We are aware that some growing banks are deliberately

[2] Less deposits with central banks

holding back on balance sheet expansion, which robs customers of the innovative financing solutions and competition they can offer.

6. Should the Bank update its definition of transactional accounts for the purposes of its indicative resolution thresholds, and if so how? The Bank would welcome feedback on whether and how it should be adjusted to take account of changes in market structure and customer behaviour.

Since the 40k – 80k transaction account deadline was proposed in 2015 the personal bank account market has changed substantially. The development of FinTech based current accounts and their ease of opening in an efficient and frictionless manner, supported by Open Banking / PSD2, and current account switching portability has encouraged customers to move away from the 'one bank account for life' model, to a multi-bank model.

Many more retail customers now have a multiplicity of quasi transaction accounts. It is now most unlikely that a significant number of individuals would be inconvenienced by the failure of a mid-tier bank, so we suggest that transaction account threshold be removed completely

If the Bank does not agree with our suggestion that the changing nature of the transaction account market obviates the need for the transaction account test at all, at least the threshold should be increased.

Most retail customers still tend to use a single 'primary' transaction account for the bulk of their banking activity, for instance:

- receiving salary or social security payments
- paying utility bills
- paying their mortgage or rent
- the repayment of credit card outstandings
- ATM withdrawals

Anecdotal evidence from members suggests that a minority of the current accounts provided by banks that are on either side of the transactional account threshold are true primary transaction accounts on which customers rely to finance their everyday lives.

Most of our building society members do not offer primary transaction accounts although some may have some transactional features associated with them. We suggest that savings accounts, which are clearly not designed to be used as primary bank accounts, should be exclude from the definition of primary transaction account. Such accounts being used in a transactional way are likely to be small and are not systemic.

We believe that the threshold number of accounts could be increased significantly and still meet the Resolution Authority's implicit upper limit of tolerance of the number of bank customers that might have difficulty in living their everyday lives should a bank providing their transaction account fail. Should an alternative to a transaction account be deemed necessary, we would be happy to work with the Bank of England on an alternative definition of primary transactional account, based on the customer's pattern of usage, referencing the types of activity utilisation, perhaps based on those listed above, although our preference is that this threshold be removed completely.

Requiring a standby bank account

We recognise that a key concern of the Resolution Authority is the speed at which a customer's primary transaction account could be transferred to another bank, which would receive a payment from the FSCS. The rate determining step is likely to be the required AML checks prior to new account opening. Speedier checks mean speedier FSCS 'cheques' and thus less customer detriment. This hurdle could be overcome were the FSCS to require any customer covered by the scheme to establish and nominate a second, backup transactional account.

The possible introduction of a national digital identity that could be linked to a national register bank accounts may provide another route to accelerate the opening of substitute bank accounts.

A further factor to take into consideration in determining the criticality of the problem of transferring primary transactional accounts is that many smaller banks typically have their accounts on a third party platform provider that is used by multiple entities and for which migrations and transfers are common. Where this is the case a discounting factor to the MREL requirement could be applied.

Reviewing the MREL regime again

We recommend that the Bank of England's MREL regime be reviewed regularly, perhaps every five years, in order that any lessons learned from 'live' resolution cases, or market developments can be taken into account.

UK Finance and its members look forward to discussing with the Bank the thoughts, observations and suggestions made in this response to the DP prior to the release of the consequent consultation paper. Given the significant overlaps with the Leverage Ratio, as we have highlighted above, it will be important that the MREL consultation paper and Leverage Ratio Review are released at the same time, to enable these two interrelated two issues to be examined together.

We look forward to meaningful change to the current MREL approach that will support a competitive banking market in the UK without compromising financial stability.

Responsible Executive

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