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

# review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

*1 October 2021*

## Introduction

1. UK Finance is the collective voice for the banking and finance industry. Representing nearly 300 firms, we act to enhance competitiveness, support customers and facilitate innovation.

2. We are pleased to respond to The Bank of England's (BoE's) Consultation paper (CP) reviewing its approach to setting a minimum requirement for own funds and eligible liabilities (MREL). This UK Finance response to the Bank's CP has been informed by extensive discussions with members, including those banks and building societies (which we collectively refer to as 'banks' herein) that are at the point of being required to hold MREL.

3. Our members comprise savings and loans firms, including mutuals, specialist banks, full-service banks and international banks. There is consequently a broad spectrum of views on the MREL consultation.

## Key messages

4. **Positive developments:** we greatly welcome the BoE's consultative approach to the development of the MREL and Leverage frameworks; the six-year glidepath for MREL requirements and the supervisory expectation relating to the application of leverage ratio.

5. **Uncertainty surrounding the transactional accounts threshold**: given the timing of completion of the review, clarity is needed for affected firms.

6. **Constrained ability to support the growth and prosperity of the UK economy**: an overarching theme is the need for UK regulators and authorities to constantly evaluate the impacts of their proposals on the success of the mid-tier and growing financial services sector and the consequent impact on customer choice and competition. We would welcome an extension of proportionality to the mid-tier sector as well as the smaller sector that the BoE is already tackling.

7. **Over-insured resolution regime**: despite the positive developments in the CP, members generally consider the regime to be over-insured in respect of the quantum of MREL, the total assets threshold and unnecessary contractual triggers.

8. **Market considerations**: lack of appetite and market for MREL issuances of mid-tier specialist and smaller banks, market signalling implications of the 2-year proposed extension to the glidepath and unnecessary freezing of unused MREL during resolution are some of the market considerations that need to be addressed ahead of the finalisation of the MREL policy.

9. **Potential solutions**: in response to the continuing challenges of the MREL regime, we suggest that the UK authorities evaluate options such as the extension and funding of FSCS, BoE collateral scheme, the British Business Bank and insurers as MREL investors.

10. **Clarification**: in addition to points covered above members would welcome clarification on interlock with leverage ratio timescales and requirements; clean holding company requirement and deduction of internal MREL.

## Detailed and supporting comments

### Positive developments

11. Both UK Finance and our members appreciate the Bank of England's approach to the policy process with the Discussion Paper, the follow-up engagement through industry discussions and bilateral meetings in the run up to the consultation paper. We thank the BoE for these opportunities for engagement and would welcome a similar approach in any and all future policy development.

12. The six-year glidepath to MREL requirements is very welcome.

13. We consider that the supervisory expectation on leverage is an elegant solution and has provided much needed clarity that reflects the BOE's approach to proportionality and appreciation of challenges facing growing firms.

### Uncertainty surrounding the transactional accounts threshold

14. Member's welcome the review of the transactional account threshold, however, we note that it will not complete until end 2022 earliest. Clarity needs to be provided for firms that are subject to MREL requirements due to this threshold before the completion of the review, or shortly thereafter to ensure that they are not required to raise MREL debt for a requirement that may then be removed

### Constrained ability to support growth and prosperity of the UK economy

15. 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. Innovation generally is often best promulgated by smaller newer entrants to markets. Now more than ever, 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.

16. 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 more

personalised underwriting and service. But the current approach to MREL penalises growth by mid-tier banks and discourages the entry of new businesses with growth aspirations.

17. 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 firm. 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 firms 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.

18. Members are concerned that the BoE interprets public interest only in the context of adverse outcomes, when public finances are required to be used in a resolution. However, the Bank and HMT, should also consider the impact of competition and the supply of credit that mid-tier firms bring in good years. Competition reduces the margin between lending and deposit gathering, oils the wheels of the economy through the supply of credit and increases employment and capital formation. Each of these improve public finances. The trade-off for these benefits must be a greater degree of acceptance of the possible risk in an idiosyncratic or market-wide tail risk event. However, this appreciation appears to be missing.

## Over-insured resolution regime

19. There is concern in the industry that due to the complexities of firms' different and often-overlapping capital requirements, the industry is over-insured, particularly in light of the breadth of other measures that have been introduced to reinforce firms' solvency and liquidity positions since the global financial crisis. Whilst we recognise there is a need for prudence to ensure that the banking system remains a key pillar in sustaining macroeconomic stability, over-insurance means that lending to the real economy suffers. This is seen none more so than through the MREL requirements on smaller firms. A report[1] from EY indicates the scale of the problem, with approximately £40 billion in potential lending to the real economy being lost. Such a loss to the real economy could also be a leading contributor to financial instability during periods of liquidity crises.

20. It is estimated that through MREL alone, the banking sector is insured to a factor of 10x the size of the losses in the UK from the global financial crisis. This seems over-cautious, and a hindrance to facilitating competition in the UK, this also consolidates the impacts on the real economy seen through the EY report referenced in the paragraph above.

### *Excessive MREL quantum*

21. We request that the PRA reconsiders the quantum of MREL. Firms believe that the calculation at 2x Pillar 1 + Pillar 2a, particularly where the Pillar 2a component (subject to supervisory discretion) can significantly inflate the MREL requirements, is more punitive than the internationally agreed FSB term sheet setting end-state TLAC at 18% RWA plus Basel III buffers. MREL should be based on the likely financial profile of the firm as it enters resolution, taking into account the balance sheet shrinking actions the firm will have taken during the implementation of its recovery plan. A reduction in the starting amount of the balance sheet against which MREL

[1] https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/topics/financial-services/ey-mrel-financial-implications-mid-size-challenger-banks.pdf

should be raised would help to facilitate competition and again, as is central to most of our responses to this CP, increase lending to the real economy and thereby helping aid macroeconomic recovery and stability.

*Competition distorting total assets threshold*

22. The current level of the total assets threshold is too low, causing a competitive disadvantage to challenger banks which in turn deprives consumers of alternative approaches to solving their banking needs. The £15-25bn threshold at which firms are required to raise MREL is substantially below that of other jurisdictions and we call upon the Bank of England to justify this obvious disparity. For example, EU banks with assets are able to meet their MREL-equivalent debt with preferred senior debt. By contrast, the UK's single point of entry and holding company MREL issuing approach creates a de facto 100% subordination requirement for any MREL. This is an important consideration as the UK makes its mark in the international banking sector post-Brexit.

23. Members believe that as firms near the £15bn threshold, they may have an incentive to stop growing to avoid the current cliff-edge effects of the extra capital requirements. There is also a concern that as smaller firms near this level of total assets, they could be incentivised to merge to create a much larger firm to facilitate greater access in the capital markets or equally they could seek to dispose of assets to avoid incurring additional MREL requirements. This would reduce competition and choice for consumers, by dampening the innovation that smaller, more nimble firms can bring. Leaving the threshold unchanged will effectively prevent any improvements in competition at the larger end of the banking sector, which is where greater competition would deliver the most impact for customers.

24. The asset size threshold should be refined now that a wider range of tools, built up since the global financial crisis, can be deployed to ensure that all firms can fail without threatening financial stability or individual customers' access to critical economic functions. It should be benchmarked to total assets less central bank deposits, aligned with the FPC leverage definition.

25. We welcome the Bank of England's suggestion that there should be a graduated increase in MREL requirements over a more extended period of time as a firm enters the (higher) range.

*Avoiding the cliff-edge*

26. Members believe that due to the potential cliff-edge of bail-in, entities having to meet twice their minimum capital requirements (albeit that in absolute terms these are quite low) when they meet the relevant threshold their costs of MREL capital is substantially higher than that of larger firms.

27. There is also clear dichotomy between two firms, separated by £1bn in total assets on their balance sheet – that is to say, a firm with £16bn in total assets would have to hold twice as much through capital requirements than one at £15bn in total assets. This seems to be a rather large cliff-edge with no real underpinning systemic risk mitigation and needs to be explained and justified. There is nothing to suggest a firm with just £1bn more in total assets would represent a much greater systemic risk to the UK banking sector. We have raised this point many times previously with the Bank and continue to do so.

28. In our response to the Discussion Paper set out in March of this year, we stated that 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",*

29. 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.. However, we believe that, whilst accounting for prudential soundness, the threshold should be nearer that of when a firm is deemed to be 'systemic' – we would therefore suggest a threshold of £50bn.

30. 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 end-state MREL, recalibrated to 18% of RWAs as per paragraph 21 above as asset size increases (as the CP suggests) from, say, £25 billion to £50 billion of total assets excluding central bank deposits. Most importantly for our members, which support this staged approach, this would overcome the sudden and dramatic cliff-edge of the jump to two times the leveraged assets amount when a firm's balance sheet exceeds, even by a very small amount, the current £15 billion asset size threshold. We are aware that some growing firms are deliberately holding back on balance sheet expansion because of this, which robs customers of the innovative financing solutions and competition they can offer.

*Unnecessary Contractual Triggers in internal MREL ("iMREL") instruments*

31. Paragraph 8.7 of the SoP covers contractual triggers in iMREL instruments. The BoE's amendments to paragraph 8.7 refers to "Internal MREL eligible liabilities must be capable of being written down and/or converted to equity without or ahead of any use of stabilisation or other statutory powers in relation to the entity which issues them". We do not believe there is any need for contractual triggers in iMREL instruments following the December 2020 update to Section 6B of the Banking Act 2009 (BA09) and ask the BoE for clarification on the practical use of the contractual triggers, noting the below.

32. Paragraph 8.8 of the SOP details the circumstances in which the BoE require contractual triggers to direct a write down or conversion of iMREL:
    1. *"any own funds instruments of the material subsidiary have been written down and/or converted into equity pursuant to any statutory or regulatory power linked to the financial condition or viability of the institution; provided that, in the case of eligible liability instruments issued by subsidiaries of non-UK groups, the Bank includes in its direction a statement that the home resolution authority has either consented or has not, within 24 hours of the Bank having given it notice, objected to the write-down or conversion;*
    2. *a resolution entity in the material subsidiary's group, which is a direct or indirect parent of the material subsidiary, is subject to resolution proceedings in the United Kingdom or elsewhere."*

33. Section 6B of the BA09 requires the BoE to exercise write-down and conversion powers in respect of 'relevant capital instruments' and, since December 2020, 'relevant internal liabilities' issued by a bank (or, by virtue of Section 81AA, a 'banking group company') in certain cases as set out in Section 6A. The cases set out in Section 6A, and when read with section 6B(8), confirm that the power in Section 6B falls to be used either (i) on a stand-alone basis, i.e. without putting the issuing entity into resolution, or (ii) where the issuing entity is to be resolved, then before or in conjunction with the relevant resolution power . Accordingly, the iMREL instruments issued by operating subsidiaries are capable of being written down and / or converted by the BoE in a pre-resolution scenario.

34. It follows from the above that the aim expressed in paragraph 8.7 and 8.8 of the BoE's MREL policy statement should be met by the updated statutory provisions which allow for pre-resolution write-down of internal MREL. Essentially, one could argue that the position for iMREL instruments should now be aligned with the BoE's stated position for non-CET1 capital instruments under paragraph 8.10. Furthermore, given the intention of the contractual trigger in both of (1) and (2) above is to be used when statutory BA09 6B powers have been used on non-CET capital instruments, or a resolution entity is subject to resolution proceedings, there is no reason not to use the same statutory or stabilisation powers on iMREL instruments.

35. We would therefore reiterate that due to the reading of paragraph 8.8 and points (1) and (2) above, there is no situation where the BoE can use the contractual triggers outside of statutory or stabilisation powers, and ask the BoE to reconsider the need for contractual triggers in iMREL instruments.

36. Also, from an accounting perspective, under IFRS 9 'Financial instruments', where a contractual non-viability clause establishes powers over and above what is already within law, it must be factored into the holder's classification assessment of the instrument. Such clauses can change the timing and amount of the cash flows in a way that could result in the instrument being deemed not to have cash flows that are solely payments of principal and interest, resulting in the holder being required to classify it at fair value through profit or loss. Due to differing rules existing for the classification of financial liabilities, this can lead to volatility in the income statement of the holding company, as well as an ongoing operational burden to produce fair valuations which are not directly observable in the market.

## Market considerations

### *Transition and constrained MREL market for smaller firms*

37. We do welcome acknowledgment from the Bank that with regards to MREL issuance, it will prove costly for smaller firms but are disappointed at the lack of recognition of tangible difficulties of raising or planning to raise MREL in the quantities needed by the smaller firms. However, the Bank's analysis only focuses on coupon, not including either transaction costs (issuance and structuring fees, rating agency fees, legal fees), which are considerable, particularly for sub-scale issues as well as the access to GBP issuance only. This represents a market failure. Whilst these smaller firms which do transition into a becoming a resolution entity will have 36 months to issue MREL in order to meet their obligations, banks will have to 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 or that there may not be any appetite for smaller firms' MREL. The same issue might repeat each time notes are refinanced ahead maturity, resulting in further over-insurance, as firms try to avoid failing to meet requirements.

38. So, we recommend that the current 36-month notice period within which a firm is expected to issue MREL be increased to five years, to allow a firm to build an 'MREL-investable' investor profile. This requires aa 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 for reinvestment given the incremental cost of resultant MREL.

39. There is also a lack of clarity regarding the application of the glide path:
    a. What is the situation for firms already meeting MREL requirements? Will the glide path apply to them? Some partial transfer firms which will be on the glidepath, already could be nearing meeting their potential future MREL requirements. As a result, there is little or no benefit to such firms from the extended transition. Some clarity regarding how a firm should amend their issuance plans would be helpful. For example, could a firm that is already on the MREL 'conveyor belt' slow down the pace at which it has to issue further MREL, meaning that they could perhaps in the future borrow at a slightly lower rate.
    b. What is the situation for firms who have not triggered MREL requirement yet but are currently above £15bn total assets or for those firms that have already forecast to be at or above £15bn in the next 3 years. Do these firms benefit from the full notice period or a reduced time period before transition?

40. Clearly there is a significant impact on competition in this scenario, as bail-in entities could have a greater advantage when it comes to raising capital and issuing MREL-eligible debt. We would ask the Bank to provide some clarity in these scenarios and how it assesses the impact on competition.

41. We also request clarity with regards to when a firm should notify the Bank that it expects to hit the £15bn threshold. The fixed nature and granularity of the glidepath could force firms, in year 2 of the transition, to issue debt that is of sub-benchmark size and outside the appetite of mainstream investors in bank debt. Although firms could bring forward debt issuance to enable a larger market-friendly issuance size, this then takes away the benefits of the new proposals of an extended transition path. Relevant members request flexibility in the glidepath transition, that firms work with the BoE to develop glidepaths fit for individual businesses with, at a minimum 50% of the MREL requirement in year 4 and meeting the full end-state in year 6.

*2 -year extension*

42. The CP helpfully proposes that firms may, subject to market and wider macroeconomic conditions at that time, may apply for an extra 2-years to meet their MREL requirements on top of the planned 6 years. However, some member firms believe that by having to apply to do this publicly means that they are signalling to the market they are struggling to raise the required capital leading to a 'circling of the vultures'

43. This could perhaps impact their ability to offer MREL-eligible debt at a certain coupon rate to finance their requirements – and smaller firms already have concerns about the premium they may be forced to pay on MREL issuance relative to larger, more systemically important firms.

44. Members would like more clarity regarding the guidelines for granting a two-year extension to the 6-year timeline for meeting MREL and the degree of market disclosure needed. Further clarity and transparency are needed on the circumstances where an extension could be obtained, for example, could an extension be granted for firms requiring additional time to achieve IRB approval? Alongside this, it would eb helpful to have the requirement that firms have taken "all necessary steps" set out in more details to make clear exactly wat firms should and need to do to obtain and extension.

45. There is also again no benefit from the potential extra 2-years that could be available to bail-in firms if a partial transfer firm.

*Pricing-out mid-tier firms*

46. Post-Brexit and post-COVID, it is perhaps even more important than ever for the UK to have a highly competitive, and innovative market, in which firms are actively encouraged to grow. However, with the current cost of MREL for firms around the cliff-edge level and just above, this incentive isn't there.

47. Due to bail-in firms having to meet a much higher level of minimum requirements, many firms will have to offer MREL issuance. However, as these are smaller firms with small bond offerings, probably at a lower rating than larger firms, the coupon on these could be much more expensive than it would be otherwise. (Tidy up meaning?)

48. Requiring firms 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 incremental 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 firms 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.

49. 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.

*Freezing of MREL during bail-in*

50. Whilst not strictly related to this consultation, we would like to reiterate our previous points to the BoE on the market and investor considerations relating to the proposed freezing of the entire EL stack during the bail-in process. We are concerned that this is not in line with investors' expectations which would therefore feed through into the pricing and market capacity for UK banks' MREL and may put UK banks at a considerable disadvantage internationally. It would also increase the risk of systemic contagion across the UK banks since if investors' holdings in a particular UK bank were frozen, they would be likely instead to sell other UK banks' MREL as a proxy. We suggest that it is not necessary from a legal nor an operational perspective to freeze the portion of the MREL that is not required as BoE as resolution authority still has full flexibility over the timing and amount of any write-down. However, it could potentially have significant adverse consequences for future issuance of MREL for the industry and not just for any UK firm that may be subject to bail-in.

**Potential solutions**

*Financial Services Compensation Scheme (FSCS)*

51. The rationale for not changing the thresholds set out in the CP is that the "Bank considers that entry into insolvency of a firm of that size [£15-25bn] would be unlikely to serve the public interest effectively, and MREL is therefore required to support a bail-in resolution strategy." However, this is predicated on the capacity of the FSCS to protect depositors in an insolvency. Given the ex-post funding structure of the FSCS and the limited funds it has available, the FSCS will need to call on public funds to protect depositors for any bank insolvency above £1.5 bn. This funding model is an outlier to Europe and the US who operate ex ante funding structures for their deposit guarantee schemes.

52. The CP provided an opportunity to set out the relative costs and benefits to the industry, depositors and the Resolution Authority of asking mid-tier banks to hold MREL versus reforming the FSCS and thereby enabling a higher indicative threshold range. In some of our members' view, the latter has the opportunity of reducing competitive disadvantages faced by mid-tier and specialist banks while at the same time providing the possibility of strengthening financial stability. Consequently, we recommend that a fundamental review of the funding of the FSCS is undertaken. The MREL thresholds should be included in this review. Given the impact on large number of mid-tier and specialist banks we believe this review by the BoE and HMT should be prioritised.

*BoE collateral scheme inspired by Mervyn King*

53. Drawing on inspiration from a former Governor of the Bank, Mervyn King in his 2016 book[2], suggested that a potential solution to reduce the level of over-insurance in the banking sector currently, is to create a system in which the Bank, or other entity, becomes a 'Pawnbroker for all seasons'. Let's call this entity UK MREL Co. Under the scheme, members designate all or some of their assets, account by account as covered and would pay an insurance premium over the course of assets. In return, UK MREL Co would be called upon in a bail-in or partial transfer scenario to purchase the designated assets at book value or at a predetermined discount, providing the member with loss absorption and a recapitalisation capacity. In turn designated assets would be deducted from member firms' MREL RWA, i.e. MREL = 2 x Pillar 1 + Pillar 2a – 1 x (Pillar 1 + Pillar 2a) x RWA designated assets.

54. The industry would work with the Bank of England and the PRA on the details of practical proposals to make UK MREL Co a reality. Initially, this could start with the most standardised products, prime residential mortgages and over time capture all products where sufficient standardisation can lead to appropriate risk assessment, for example where either there is an active securitisation market or sufficient number of comparable banks applying IRB approaches.

55. This approach simplifies the over-insured nature of current regulations and in our view would free up lending that can be provided to the real economy as capital requirements could be adjusted down.

*British Business Bank as MREL investor*

56. Would the British Business Bank be able to purchase MREL issuance from mid-tier firms in order to facilitate competition? And therefore, forgo the potential cliff-edge of firms avoiding reaching the £15bn threshold so that they do not have to issue expensive MREL debt to meet their requirements.

*Solvency II review: encourage other market participants*

57. As part of the review of Solvency II, we invite the Bank of England and the PRA to consider how the insurance industry can be encouraged to be a participant in the MREL market in a fashion that broadens the investor base of MREL instruments, while not undermining the safety and soundness of the insurance sector.

## Clarification points

*Clean holding company requirement*

58. Many banking groups rely on structural subordination for their holding company senior eligible liabilities instruments to count as MREL. There are a number of clean holding company requirements that are set out under relevant regulations/policies, which are designed to ensure that the holding company of the group, which is the issuer of the senior eligible liabilities has a clean balance sheet and hence limits the risk of No Creditor Worse Off compensation claims being made during a bail-in process. The clean holding company requirement are formulaic calculations which looks at the amount of MREL held by the holding company versus a set of thresholds, the result of which is used to cap the amount of certain liabilities on the balance sheet of the entity. The clean holding company rules are embedded under two frameworks:

[2] The End of Alchemy: Money, Banking, and the Future of the Global Economy, *Little, Brown* 2016, ISBN 978-0-349-14067-4

- the Capital Requirements Regulation as amended (hereafter “UK CRR”).
- Similar provisions are also part of the MREL framework established by the Bank of England through the publication of the Statement of Policy on Internal MREL issued last June 2018 (hereafter “MREL SoP”).

59. UK banks are concerned about the application of two overlapping frameworks both of which aim to govern the same risk. The two frameworks, one legally binding and applicable since June 2019 (UK CRR) and one which sets out important expectations by the UK resolution authority (the MREL SoP) diverge considerably. We would like clarification on the following issues and suggest the deletion of the MREL SoP clean holding company requirement on the basis that UK holding companies which are resolution entities are already bound by the clean holding company requirement under the UK CRR and have built capabilities to meet those set of rules and the definitions therein.

60. The UK CRR under article 72b(2)(4)(d) refers to the ‘on balance sheet excluded liabilities’ of the issuer – the term ‘excluded liability’ is defined in UK CRR under article 72a(2), however the overlapping requirement in the BoE SoP refers to “*other liabilities that do not meet the MREL eligibility criteria set out in the No. 2 Order”.* It is unclear why the BoE would extend the scope of those liabilities to a scope that is wider than that of the UK CRR. This appears also wider than that envisaged by the Financial Stability Board in the TLAC Term Sheet which seek to limit the amount of those liabilities which are excluded and therefore should not be bailed in. The BoE SoP should be amended to reflect the concept of ‘excluded liability’ in line with the UK CRR. We note also that the Commission Delegated Regulation (EU) 2016/1450 part of UK law which contemplates a similar requirement to that envisaged under the MREL SoP under article 3(3) clearly determines the test should be performed on excluded liabilities only.

61. While the UK CRR requirement is specific to those liabilities which are ‘on balance sheet’, the MREL SoP on the other hand is silent on this and does not specify clearly whether off balance sheet contingent liabilities should also be assessed. We note however the Resolvability Assessment Framework document published in July 2019, point 4.13 refers also to *‘firms should have particular regard to on-balance sheet and off-balance sheet liabilities that may rank pari passu with any MREL resources’.*

62. This discrepancy between UK CRR and MREL SoP raises unwarranted issues; off-balance sheet liabilities should not be included in a clean holding company calculation, because, in reality, those liabilities are very unlikely to materialise merely as a result of a bail-in. In addition, as a practical matter, it is very unclear how such off-balance sheet liabilities would be measured for the purpose of a clean holding company requirement. Our strong view is that the UK CRR should be followed instead, and that off-balance sheet liabilities should not be included in the calculation. We note that both FSB TLAC Term Sheet and the detailed requirement for a clean holding company under the Federal Reserve rules clearly exclude contingent liabilities from the assessment.

### *Deduction of internal MREL*

63. 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.

64. 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)).

65. 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.

66. The proposal is inconsistent 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.

67. 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 BRRD3. We 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.

*Interlock with leverage ratio timescales and requirements*

68. The consultation process around leverage and MREL is very helpful and [some of] our members consider the supervisory expectation on leverage to be an elegant solution which has also provided much needed clarity.

69. We would however encourage a more coherent approach to the leveraged-aligned measure for MREL, particularly where a firm is not required to meet leverage ratio as part of its capital-based requirements but is required to meet a leverage-based requirement for MREL.

70. Certain UK banking entities, for example material subsidiaries of overseas banks, are not subject to the leverage ratio but are in the position of their MREL binding constraint being the leverage exposure-based MREL measure, which lacks coherence when the leverage ratio is not considered necessary for their capital-based prudential requirements. The on-shored version of CRR II (article 92b) also requires material subsidiaries to maintain internal MREL calibrated at 90% of the higher of 16% of RWAs or 6% of leverage exposure (and 18% of RWAs or 6.75% of leverage exposure from 1 January 2022). The leverage exposure component of the requirement is similarly inconsistent with the scope and timing of the UK Leverage Ratio framework.

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[3] 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)

71. In addition, without a UK Leverage Ratio for the capital-based requirement, the current approach to deduction of buffers from MREL resources yields an incongruous outcome: under PRA Supervisory Statement 16/16 “The minimum requirement for own funds and eligible liabilities (MREL) – buffers and Threshold Conditions” firms with no leverage ratio requirement must deduct the RWA-based capital buffers in full from the resources available to meet MREL requirements. This is the case even for the firms discussed above that have leverage-based MREL as their binding constraint but are not subject to a UK Leverage Ratio requirement. This therefore leads to a ‘worst of both worlds’ outcome, rather than establishing an ‘effective buffer’ (the stated aim of the framework). We request that the BoE seeks to establish a better interaction between the applicable UK leverage and MREL regimes for these firms. We would propose that firms that are not required to comply with a leverage ratio also not be required to meet the leverage-based MREL requirement and are instead required to comply with the risk-based MREL ratio only.

## Follow-up

72. We stand ready to discuss our response and work with the BoE on any potential solutions that may bring a more appropriate and innovative regime that is still prudentially sound but also supports the UK through the growth and success of the mid-tier and challenger firms as well as ease of operation of larger and international firms.

73. If you have any questions relating to this response, please contact Nala Worsfold (nala.worsfold@ukfinance.org.uk) or Simon Hills (simon.hills@ukfinance.org.uk).