Response

to

The Bank of England's Consultation Paper titled:

"*The Bank of England's review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL)*"[1]

from

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[1] BoE Consultation Paper, "*The Bank of England's review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL)*", July 2021.

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Executive summary

1. We welcome the consultation proposals by the Bank of England (BoE) which are aimed at updating its existing policy approach to setting a minimum requirement for own funds and eligible liabilities (MREL). We believe the proposals, should they become final policy, represent a markedly positive shift in the drive to reduce barriers to entry and promote competition in the UK banking sector.

2. We strongly support the BoE's proposals to significantly increase the timeline required for complying with MREL for newly affected firms and to address the cliff-edge effects inherent in its existing MREL Policy. We consider that the proposed introduction of a notice period, a transition period, a flexible add-on period, and a stepped glide-path will represent a major improvement in the BoE's MREL Policy. It is also clear evidence that the BoE has taken very seriously the industry's myriad concerns about MREL.

3. We also strongly support the BoE's proposals around the thresholds for triggering the resolution strategies that lead to the imposition of MREL i.e. Partial Transfer and Bail-in resolution strategies. In particular, we welcome the proposal to replace the current indicative total assets range with a single indicative total assets metric, and the possibility to significantly raise or remove the transactional accounts threshold.

4. Notwithstanding the above, we think the BoE has an opportunity to go even further by considering additional changes to the regime. For instance, we argue in favour of moving away from the concept of a 'loss absorption amount' with the focus instead on the meaningful part of MREL (from a resolution perspective this is) i.e. the 'recapitalisation amount'.

5. Further, as a matter of principle, we believe that MREL by nature should ideally only be applicable to systemic firms (i.e. G-SIBs and D-SIBs[3]) but recognise the BoE's desire to have optionality in a resolution event where the circumstances do not conform to the BoE resolution strategy designed *ex-ante* for a given firm.

6. Finally, whilst systemic firms should be subject to a calibration of MREL that doubles their minimum capital requirements (reflecting the risks they pose to financial stability), non-systemic firms should be set MREL at a much lower level compared to systemic firms.

[3] Domestic Systemically Important Banks (D-SIBs) and Global Systemically Important Banks (G-SIBs).

Introduction

7. We welcome the review by the Bank of England (BoE) of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL), and the Consultation Paper in this respect. **Midelatory Consulting** is grateful for the opportunity to respond to this public consultation.

8. Having responded formally to the Discussion Paper that preceded this consultation and raised a number of issues with the existing regime, our overall impression of the Consultation Paper is that the BoE has clearly listened to industry feedback and adjusted its proposed approach to MREL to a material extent. We are hugely supportive of the proposals under consultation.

Changes to the transactional accounts threshold

9. In Midelatory Consulting's response to the BoE's December 2020 Discussion Paper, we argued that:[4]

> *"The indicative threshold is really such a small number of accounts that its practical (even if unintended) effect is to serve as a potential barrier to new entrants to the banking sector.*
> *…*
> *We would suggest that the indicative threshold be revisited, and that the BoE should consider a much larger threshold*."

10. We, therefore, welcome the fact that the BoE is considering whether to significantly raise or remove the indicative 40,000 to 80,000 transactional accounts threshold, which is currently used to determine whether a mid-tier firm should be subject to a Partial Transfer resolution strategy (and, therefore, MREL). We acknowledge that this is subject to the BoE doing further work with the industry, FSCS, FCA, and PRA to develop "*alternative processes which may reduce disruption to transactional accounts in the event of an insolvency procedure*" – in recognition of technological and market developments in the last few years.

11. In the meantime, we consider helpful the BoE's intention to engage actively with firms that may exceed the (current) transactional accounts threshold in the near future while further work takes place. In particular, it will be important to engage applicant firms during the pre-authorisation phase. This means that PRA personnel dealing with a bank applicant's authorisation process may need to involve the relevant BoE resolution experts at an earlier stage than would previously have been the case. This is important as the pre-authorisation process is arguably where the barriers to entry and anti-competition impact of the existing MREL Policy reveal themselves the most.

Changes to the total assets threshold

12. We welcome the BoE's proposal to replace the current indicative range of £15-25bn of total assets (which may necessitate the imposition of a Bail-in resolution strategy) with a single

[4] Midelatory Consulting's Response to the "*Bank of England's Discussion Paper: The Bank of England's review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL)*", March 2021.

indicative metric of £15bn of total assets. This was something that we argued strongly for in Midelatory Consulting's formal response[5] earlier this year to the BoE's Discussion Paper.[6]

13. A single indicative figure rightly reflects the reality that firms are not able to effectively conduct business planning activities on the basis of thresholds set as a range and are in practice compelled to proceed on the basis of the lowest end of the range. Although we continue to believe that the figure of £15bn is overly conservative i.e. too low, we nevertheless welcome the clarity afforded by having a single number for business planning purposes.

Changes to the timeline for meeting a newly applicable MREL requirement

14. We welcome, and indeed applaud, the BoE's proposal to introduce both a 'notice period' and a 'transition period' for meeting newly imposed MREL requirements.

Notice period

15. The BoE proposes a notice period of at least three years after a firm has been made aware of its future MREL but before the firm needs to begin fund-raising activities to meet the new requirement. This has the positive effect of providing an early signal to a firm's management, board and investors of likely future requirements based on its own growth projections, without also the panic of needing to raise funding in the short term, or indeed the potential inability to do so depending on the prevailing market conditions.

Transition period

16. The BoE also proposes a transition period of six years for an affected firm to meet its full end-state MREL requirement. Helpfully, the BoE proposes, as part of the six-year period, two intermediate steps which provide a so-called "*stepped glide-path*":

    - Step 1: Two years into the transition period, the firm must meet at least 33% of its MREL.

    - Step 2: Four years into the transition period, the firm must meet at least 66% of its MREL.

Flexible add-on period

17. The BoE proposes a discretionary tool for itself for extending the six-year transition period by a period of up to two years (so-called 'flexible add-on period') to address possible idiosyncratic challenges or market dislocations that may negatively impact a firm's ability to issue MREL instruments during the original six-year transition period. This is positive as it seeks to future-proof the proposed MREL Policy by baking regulatory flexibility into the future regime whilst providing relative certainty of regulatory approach.

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[5] Ibid.

[6] BoE Discussion Paper, "*The Bank of England's review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL)*", December 2020.

Impact on competition

18. We believe the BoE's proposals will have a materially positive impact on competition in the UK banking industry. In Midelatory Consulting's response to the BoE's December 2020 Discussion Paper, we stated:

> "*Drawing on our experience of advising various start-ups in the UK banking industry, there is no doubt that prospective firms consider MREL a material barrier to entry into the sector. The barrier effect seems to be driven by two factors: first, the thresholds mean that virtually any prospective firm that intends to offer current accounts has to immediately contend with MREL in its financial projections. Second, the sheer quantum of MREL is problematic for those firms (non-systemic by definition) i.e. the doubling of minimum capital requirements is a genuine consideration for those firms, casting doubt on their ability to attract sufficient investment.*"

19. We are pleased that the BoE has taken on board the concerns we raised about MREL acting as a barrier to entry into the UK banking sector, thus posing an impediment to effective competition. The introduction of the stepped glide-path (including the two intermediate steps) will go a long way to alleviate this barrier to entry. It will also help reduce the cliff-edge effect that is present in the BoE's existing policy in this area. A firm will, in effect, have up to five years from the start of the notice period to the first step (when it needs to meet 33% of its MREL) in the BoE's stepped glide-path. The result is that a firm will have at least nine years in total to meet a newly-set MREL requirement in full – a big change from the existing policy of at least three years of transition.

20. We, at Midelatory Consulting, believe it is appropriate for there to be a proportionate prudential "price" to pay for growth where such growth significantly increases the systemic importance of a given firm. Put another way, if a firm's growth trajectory is such that the potential adverse impact of its failure on the financial system increases significantly, then the BoE is duty-bound to reflect this fact in its assessment of the firm's resolvability.

21. Therefore, having clear sight of the nature of this price well ahead of time and, equally, being afforded what can only be described as a generous transition period is a hugely positive development that seeks to promote a competitive landscape in the UK banking sector. New bank applicants can proceed with their business plans without having to immediately contend with MREL in their financial projections.

Impact on proportionality

22. The BoE's proposed approach also addresses some of our concerns around the lack of proportionality in its existing MREL Policy as it pertains to smaller and mid-tier firms. In Midelatory Consulting's response to the BoE's December 2020 Discussion Paper, we stated:

> "*We believe bail-in, in the form of MREL, should ideally only apply to systemic firms (G-SIBS and D-SIBs). In the event that it continues to be applied more widely than that, there should be real proportionality built in*."

23. We are therefore happy to see the BoE's proposals reflect the need to tailor any application of MREL to non-systemic firms in a manner that is not disproportionate given the lower levels of risk posed by such firms to the stability of the financial system. Such firms can, in future,

operate in an environment where they not only have sufficient time to prepare for MREL, but also an abundant timeline to actually build up MREL resources through, for example, issuances at preferable points in the economic cycle.

24. The possibility of the BoE adding a flexible add-on period of up to two years will enable it to exercise judgement on whether the specific circumstances of a given firm warrants additional proportionality. However, this flexible add-on period should only be used in exceptional circumstances and, so, it is appropriate that firms plan on the basis of a six-year transition period which we believe is sufficient for most firms' circumstances.

25. In our view, the combination of a notice period, a transition period (including the flexible add-on period), and the two intermediate steps as part of the stepped glide-path will, if confirmed as final policy, represent a major shift and an improvement in the BoE's MREL Policy. It is also clear evidence that the BoE has taken the industry's concerns about MREL very seriously.

Areas in which the MREL Policy can be further enhanced

26. As noted earlier, we are mainly supportive of the proposals under consultation. However, we believe there are areas in which the BoE can go even further to enhance its MREL Policy.

The logical construction of MREL

27. We note from the Consultation Paper that the BoE has chosen to retain the construction of MREL as the sum of two components: a loss absorption amount and a recapitalisation amount. We continue to be of the view that MREL should be defined as the recapitalisation amount only (i.e. the 'bail in' element) since this is the portion required for recapitalisation in the event of a firm's resolution. The ongoing MREL Review is an opportunity for the BoE to make the regime more logical and less confusing. Since the key task of setting MREL is determining the recapitalisation amount, that is ideally where the entire focus of a bail-in requirement should lie. That is, a more logical approach would be to apply the MREL regime only to those firms for which the recapitalisation amount would be set above zero.

28. That said, whilst the concept of a loss absorption amount is arguably redundant in practice, we acknowledge that our view is more to do with ensuring clarity and a better logical underpinning than a substantive objection. The essential elements of the BoE's Policy in this context remains prudentially sound i.e. that whilst MREL theoretically applies to all CRR firms, the fact remains that those firms for which a bail-in requirement is inappropriate (e.g. firms that would be resolved using the Modified Insolvency strategy) will simply have their recapitalisation amount set at zero.

Scope of the MREL regime

29. As a general principle, we consider that only systemic firms (i.e. G-SIBs and D-SIBs) should have an MREL requirement for the reasons set out in our response to the BoE's December 2020 Discussion Paper. That is, where the failure of a firm is unlikely to adversely impact financial stability, such a firm should not have an MREL requirement. However, we recognise the BoE's desire to have resources in place that 'buys it time' to, for instance, secure a purchaser for part of a firm's business or indeed to help it deal with the possibility that such a purchaser is not forthcoming in a crisis.

30. The BoE states in the Consultation Paper:

> "*At the point of actual failure, the choice of actual resolution strategy will take into account the circumstances of failure and may therefore vary from the preferred resolution strategy adopted during resolution planning. In the event of an actual failure, the Bank may consider it necessary in the public interest to place a firm into resolution despite it having previously set an insolvency strategy due, for example, to wider market dislocation and instability at the point of actual failure. The absence of a willing private sector purchaser might make a bail-in necessary for a firm with a partial transfer strategy*."

31. Since the resolution regime is designed to reduce the 'impact' of failure (rather than its 'probability'), it is easy to understand the BoE's logic in wishing to impose MREL on those mid-tier firms that fall into the Partial Transfer resolution strategy. We acknowledge the BoE's concern that the *ex-post* reality of firm failure may not conform with the *ex-ante* resolution strategy.

Calibration of MREL

32. In line with our response to the BoE's December 2020 Discussion Paper, we continue to agree with the BoE's approach of calibrating the quantum of MREL for G-SIBs and D-SIBs as an amount that is twice the minimum capital requirement i.e. a doubling of the sum of its Pillar 1 and Pillar 2A requirements – so that the firm can be fully recapitalised should its minimum capital requirements be completely depleted.

33. However, it follows that the calibration of MREL for non-systemic mid-tier firms should reflect their non-systemic nature. That is, for such firms, MREL should be set at a lower level compared to systemic firms, for instance, at one-and-half times their minimum capital requirement, rather than a doubling (as is rightly the case for G-SIBs and D-SIBs).

Conclusion

34. To conclude, we welcome the BoE's obvious efforts to take account of industry concerns in this important area of prudential policy. The BoE is to be applauded for capitalising on this unique opportunity (of a major reshaping of regulatory policy following the UK's exit from the EU) to improve the UK's MREL regime by making it more proportionate. It is noteworthy that the BoE has taken account of the competition impact of its MREL Policy despite not having a statutory obligation to do so (unlike the PRA which does have a secondary statutory objective to facilitate effective competition in the financial sector).

35. The proposed changes to the timeline for meeting MREL – consisting of a notice period of at least three years, a standard transition period of six years, a possible flexible add-on transition period of up to two years, and a stepped glide-path – amount to a major concession in favour of much greater proportionality and competition in the UK banking industry. It is also clear evidence that the BoE has carefully considered the industry's views about MREL.

36. The ability of new and fast-growing firms, as well as new bank applicants, to conduct business planning activities confidently without having to immediately contend with MREL is a significant boost to much-needed competition in the UK banking sector. Similarly, the BoE's proposal to replace the current indicative total assets range with a single indicative metric of £15bn of total

assets, and the possibility of significantly raising or removing the transactional accounts threshold, are unequivocally positive developments in reducing barriers to entry and promoting competitive growth in the UK banking sector.

37. We support the maintenance of strong prudential standards in the UK in the post-Brexit policy shape-up. We further support a robust bail-in regime as part of that framework and welcome the proportionality and pro-competition mechanisms proposed in the Consultation Paper.

Thank you.

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