BANK OF ENGLAND

Resolution

Policy Statement

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

December 2021

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Following the Introduction, this document contains:

- An overview of the Bank's revised approach to setting a minimum requirement for own funds and eligible liabilities (MREL), including as regards resolution strategy thresholds, calibration of MREL, MREL eligibility and intragroup MREL distribution.

- Feedback on the Bank's July 2021 Consultation on 'The Bank of England's review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL)' and proposed changes to the text of the Bank's MREL Statement of Policy.

The Annex to this document contains the Bank of England's revised Statement of Policy for exercising its power to direct relevant persons to maintain a MREL under sections 3A(4) and (4B) of the Banking Act 2009.

Contents

Introduction

Background

The Bank of England (the Bank), as the UK resolution authority, is responsible for taking action to manage the failure of certain financial institutions[1] and/or their groups[2] – including UK-headquartered banking groups and UK-incorporated banks and building societies (collectively, firms) – a process known as 'resolution'. Resolution allows the shareholders and unsecured creditors of a failed firm to be fully exposed to losses, while ensuring the critical functions of the firm can continue and helping to preserve financial stability. Resolution reduces risks to depositors, the financial system, and public funds that could arise due to the failure of a firm. By ensuring losses will fall on a failed firm's investors, rather than depositors or taxpayers, and ensuring the continuity of critical functions performed by firms on which their customers and clients depend, resolution can both reduce the risk of firm failures by supporting market discipline and limit the impact of failure when it does occur.

The minimum requirement for own funds and eligible liabilities (MREL) is a minimum requirement for firms to maintain equity and eligible debt that can be 'bailed in' or otherwise support a resolution should a firm fail.[3] MREL must be set in line with the provisions of the Banking Act 2009 (the Banking Act), the No. 2 Order and relevant binding technical standards, including the MREL UKTS.[4] The purpose of MREL is to help ensure that, should a firm fail, the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business and support its restructuring. This reduces the likelihood that governments use public funds to rescue failing banks and in effect 'bail out'

1 The relevant financial institutions are i) banks, building societies and certain investment firms that are authorised by the Prudential Regulation Authority (PRA) or Financial Conduct Authority (FCA); (ii) parent companies of such firms that are financial holding companies or mixed financial holding companies (holding companies); and (iii) PRA or FCA-authorised financial firms that are subsidiaries of such firms or such holding companies. From 1 January 2022, subject to Parliamentary approval of The Financial Services Act 2021 (Prudential Regulation of Credit Institutions and Investment Firms) (Consequential Amendments and Miscellaneous Provisions) Regulations 2021, investment firms which are regulated only by the FCA will be removed from the provisions related to the resolution regime set out in the Banking Act 2009 and therefore fall outside the scope of MREL.

2 In this document, references to 'group' or 'banking group' should, unless otherwise stated, be interpreted as any group comprising one or more entities referred to in (i) to (iii) in the preceding footnote, whether located and authorised in the United Kingdom or elsewhere.

3 The Bank Recovery and Resolution (No. 2) Order 2014 (the No. 2 Order) – requires the Bank to use its power under section 3A of the Banking Act to set a minimum requirement for own funds and eligible liabilities for relevant institutions. The Bank's power of direction applies to: (i) banks, building societies and certain investment firms that are authorised by the PRA or FCA (institutions); (ii) parent companies of such institutions that are financial holding companies or mixed financial holding companies; and (iii) PRA or FCA-authorised financial institutions that are subsidiaries of such institutions or such parent companies. For the purposes of this paper, references to an 'institution' should in general be taken to also include the entities referred to in (ii) and (iii). The Bank is the United Kingdom's resolution authority, and the PRA or FCA is the competent authority.

4 The MREL UKTS means the MREL Technical Standards and refers to European Commission Delegated Regulation (EU) 2016/1450 as retained in UK law. Technical Standards have been updated by the Bank to reflect the UK's withdrawal from the EU pursuant to the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018, see in particular the Technical Standards (Bank Recovery and Resolution) (Amendment etc.) (EU Exit) (No. 1) Instrument 2019.

their creditors, as was the case during the global financial crisis that began in 2007. During that crisis the bailouts were the only means of avoiding the negative consequences that firm insolvencies would have had on their depositors, the wider financial system, and the economy as a whole – in other words, certain firms were 'too big to fail'.

Since the global financial crisis, the primary objective of international regulatory initiatives has been to end 'too big to fail' for the largest and most complex firms. That crisis, as well as earlier periods of banking industry stress, have demonstrated that the failures of medium-sized firms also have the potential to cause substantial disruption to customers and clients and put public funds at risk. Therefore, in order to reduce the likelihood of disorderly failure or bail-out, medium-sized firms also need to comply with standards set proportionately to achieve their orderly resolvability consistent with statutory objectives. MREL in excess of minimum capital requirements is therefore a critical element of an effective resolution regime for both larger and medium-sized firms.

Structure of this document

Following feedback to its December 2020 Discussion Paper (DP),[5] the Bank consulted on changes to its policy on MREL in July 2021 (the July 2021 Consultation Paper, or the CP).[6] We received 20 responses to our consultation from a variety of financial firms, consulting firms, industry bodies and others. This document provides feedback on the main issues raised in consultation responses, sets out where we have made changes to our policy, and clarifies our policy approach where relevant.

The rest of this document is structured as follows:

- Context and summary of changes to policy - provides an overview of the changes to the Bank's approach to the resolution strategy thresholds, calibration of MREL, MREL eligibility and intragroup MREL distribution;

- Feedback on the Bank's July 2021 Consultation Paper - discusses the main themes raised in consultation responses and provides additional information on our approach where relevant; and

- Annex - sets out the Bank's revised Statement of Policy on our approach to setting MREL.

The Bank's MREL review in the context of regulatory developments

The Bank first published its MREL policy in 2016, updating it in 2018[7] to reflect the Bank's approach to the intragroup distribution of MREL resources. The Bank reaffirmed in June

5 The Bank of England's review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL), December 2020

6 The Bank of England's review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL), July 2021

7 The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL), June 2018

2018 that it would review the calibration of MREL and the final compliance date, prior to setting their 'end-state' MRELs (that is, the final MREL that they will need to meet once the transitional glide-path has concluded), having particular regard to any intervening changes in the UK regulatory framework as well as firms' experience in issuing liabilities to meet their interim MRELs.

In light of challenges faced by some firms which are not global systemically important banks (G-SIBs)[8] or domestic systemically important banks (D-SIBs),[9] but which are currently in scope of stabilisation powers and therefore subject to MRELs in excess of their minimum capital requirements,[10] and to enable the Bank to take into consideration the Financial Policy Committee (FPC) and Prudential Regulation Authority (PRA)'s review of the UK leverage ratio framework, in December 2020 the Bank delayed the end-state compliance date for this group of firms by one year, from 1 January 2022 to 1 January 2023.[11]

The Bank issued its DP in December 2020 as the first stage of the MREL Review, and opened up a broad dialogue with interested parties on the development of the MREL framework. Given medium-sized banks and building societies' experience of issuing MREL-eligible instruments the focus of the DP was on these firms. In this document we use the term 'mid-tier firms' to refer collectively to the banks and building societies for whom the Bank has adopted (or will in the future adopt) a preferred resolution strategy which involves the use of stabilisation powers and for whom the Bank has (or will) therefore set end-state MRELs in excess of minimum capital requirements, but who are not at the relevant time G-SIBs or D-SIBs (or their subsidiaries).

Having gathered feedback and ideas from stakeholders to inform the Bank's views on the policy choices in the MREL Review, the Bank then engaged stakeholders on more detailed proposals in the CP. The Bank has also taken account of the FPC and PRA review of the UK leverage ratio framework in light of revised international standards, and broader market, technological and regulatory developments. These regulatory developments include the PRA's Discussion Paper, 'A strong and simple prudential framework for non-systemic banks and building societies'[12] and the PRA's Policy Statement, 'Non-systemic UK banks: The Prudential Regulation Authority's approach to new and growing banks'.[13] The Bank has also considered the terms of the UK's withdrawal from the European Union[14] and the impact of extraordinary public health measures on the financial sector.

[8] G-SIBs are those firms so identified by the Financial Stability Board in consultation with the Basel Committee on Banking Supervision and national authorities.

[9] D-SIBs are those institutions with retail deposits over £50bn and/or any institutions that are designated as an O-SII (other systemically important institution) by the PRA pursuant to the Capital Requirements (Capital Buffers and Macroprudential measures) Regulations 2014, and which have a resolution entity in the United Kingdom.

[10] Pillar 1 plus Pillar 2A or, if higher, any applicable leverage ratio

[11] Some mid-tier firms currently have MREL end-state compliance dates after 2023. The end-state compliance dates for these firms remained unchanged at that time.

[12] DP1/21 – A strong and simple prudential framework for non-systemic banks and building societies, April 2021

[13] PS8/21 – Non-systemic UK banks: The Prudential Regulation Authority's approach to new and growing banks, April 2021

[14] Following the end of the UK-EU Withdrawal Agreement Implementation Period on 31 December 2020, EU legal provisions relating to the Bank's obligations and powers as resolution authority that were not already transposed into UK law were 'onshored' with necessary modifications (but no other changes of substance) via legislation pursuant to the European Union (Withdrawal) Act 2018 . The Bank is now able, following public consultation and with other UK authorities, to amend the onshored technical standards on MREL.

In finalising changes to our MREL policy, we have considered the feedback provided in response to our earlier DP and to our CP. The feedback to the CP is summarised in this document. We have consulted with HM Treasury and other relevant authorities namely, the PRA, the Financial Conduct Authority (FCA) and the Financial Services Compensation Scheme (FSCS). The Bank is grateful to all those who responded to the DP and the CP, and for the constructive engagement which followed.

The policy changes are ultimately intended to help ensure that all firms, including mid-tier firms and major UK firms, can be resolved in an orderly manner consistent with the Bank's statutory objective to protect and enhance UK financial stability, as well as the statutory objectives of the UK's special resolution regime (special resolution objectives) to which the authorities must have regard when using or considering the use of stabilisation powers (set out in section 4 of the Banking Act and summarised in Figure 1 below).[15] The final MREL policy incorporates two significant changes to ensure it is proportionate. First, it provides new and growing firms with a clear, stepped and flexible glide-path to meeting their end-state MRELs. Growing firms will now have an advance 'notice period' of ordinarily three years before the start of their transition to end-state MREL, and six years starting from the point at which their transition begins to meet their end-state MREL in full, with either one or two intermediate steps to smooth any 'cliff-edge'. There will also be scope for firms to request a flexible two year add-on, should circumstances warrant it.

In addition, the Bank has initiated work to be carried out in consultation with the banking industry, FSCS, FCA, PRA and other interested parties with a view to developing alternative processes which may reduce disruption to transactional accounts in the event of an insolvency procedure. Subject to the outcomes of this work, the Bank is considering whether it could significantly raise or remove the indicative 40,000 to 80,000 transactional accounts threshold for the adoption of a partial transfer strategy and, therefore, an MREL that is above a firm's total capital requirement. This work will take some time to complete and so the Bank does not envisage being able to make any consequential changes to resolution strategies and MRELs for individual firms before end-2022 at the very earliest.

The approach set out in this document has been designed in the context of the UK having left the European Union and the transition period having come to an end. Unless otherwise stated, any references to EU or EU derived legislation refer to the version of that legislation which forms part of retained EU law.[16] The Bank will assess whether any further changes would be required due to any future changes in the UK regulatory framework.

The revised MREL Statement of Policy will apply from 1 January 2022.

[15] Section 4 of the Banking Act sets out the seven special resolution objectives and provides that they are to be balanced as appropriate in each case.

[16] For more information, please see Transitioning to post-exit rules and standards | Bank of England.

Figure 1: The special resolution objectives and what they mean for resolution

The authorities must have regard to the special resolution objectives when using or considering the use of stabilisation powers, but they are not ranked in any particular order. The authorities must consider how to balance these objectives in each individual case, including which of them are to be prioritised if they conflict.

Ensure the continuity of banking services and critical functions in the United Kingdom

- If a bank fails in a disorderly way, customers may suddenly lose access to their bank accounts and they might not be able to pay their bills or buy groceries – or even complete larger transactions, such as house purchases.
- At the same time, the failed bank may stop offering new lending to its customers, reducing economic activity.
- Resolution allows us to minimise disruption to ordinary people's day to day lives, and to business and to the wider economy.

Protect and enhance the stability of the UK financial system

- We have seen before that one bank failure can cause a domino-effect that brings down other banks, resulting in even greater withdrawal of lending and other critical functions and creating a crisis.
- Resolution enables one bank to fail in an orderly way without seriously damaging other banks or the wider economy.

Protect and enhance public confidence in the UK financial system's stability

- If one bank fails and its customers cannot access their money or pay their bills, customers at other banks may lose confidence in the banking system and take precautions that, inadvertently, increase the risk that their banks also fail.
- Resolution protects customers from disruption, reducing the risk of customers losing confidence in the banking system.

Protect public funds, including by minimising reliance on extraordinary public financial support

- In the past, governments were left with no viable option but to use public funds to rescue distressed banks, because of the potentially highly disruptive consequences of allowing them to fail.
- Resolution protects public funds by making the owners and creditors of the bank bear its losses instead.

Protect depositors and investors covered by relevant compensation schemes

- The Financial Services Compensation Scheme provides a guarantee that depositors' and investors' money will be protected from loss (up to a limit).
- Resolution supports this protection by enabling depositors to continue to access their funds in failure.

Protect, where relevant, client assets

- Banks hold assets on behalf of their clients and these clients must be able to access their assets quickly if their bank fails.
- If a bank fails, the resulting resolution action should not hinder the ability of the bank's clients to access their assets.

Avoid interfering with property rights, in contravention of the European Convention of Human Rights

- People have a right to the peaceful enjoyment of property, which includes ownership stakes and creditor claims.

- Resolution can involve altering bank owners’ and creditors’ property rights, so it is essential that resolution action is only taken when it is in the public interest and subject to appropriate safeguards, including measures to ensure that no creditor is left worse off than they would have been in an insolvency.

The Bank’s overall framework for setting MREL

The Bank aims to maintain a fit and ready resolution regime: fit for the purpose of maintaining financial stability and market discipline; and ready to be put into action to deal with the failure of one or more firms. The Bank’s overall approach to ensuring resolvability supports financial stability through strong, effective and proportionate standards appropriate for the maintenance of a credible resolution regime[17].

The Bank sets MREL for individual firms and their groups to achieve one of three broad resolution strategies – modified insolvency (insolvency)[18], partial transfer, or bail-in. These strategies are designed to reflect the scale and nature of the impact of a firm’s failure. The Bank determines a resolution strategy for each firm, in line with its legislative obligations including taking into account the expected impact of the firm’s failure and the likely impact on the special resolution objectives, and sets the firm’s MREL to support the effective execution of that strategy.

The Bank must ensure that, if a firm met the four conditions for resolution set out in section 7 of the Banking Act,[19] it could credibly use the stabilisation powers to resolve the firm in line with the special resolution objectives. The Bank therefore effectively needs to reach a judgment on whether or not, if a firm were to meet the first two conditions for resolution – that is, the firm is failing or likely to fail and it is not reasonably likely that action can be taken to avert that failure or likely failure – the final two conditions would also be met – that is, it is necessary to exercise stabilisation powers having regard to the public interest in the advancement of the special resolution objectives and, if so, that one or more of the special resolution objectives would not be met to the same extent by the winding up of the firm.

If the Bank considers that the winding up of the firm would be feasible and credible (meaning, in effect, that the Bank considers that the final two conditions for resolution would be unlikely to be met), it sets a preferred resolution strategy of insolvency and MREL is set at a level equal to the firm’s minimum capital requirements, because there is no need

[17] For more information, see The UK’s progress on resolvability - speech by Dave Ramsden, Deputy Governor, Markets, Banking and Resolution, February 2021.

[18] The Banking Act provides for a number of modified insolvency regimes for certain institutions (the bank insolvency procedure (BIP), building society insolvency procedure (BSIP) and the special administration regime (SAR)). The special administration regime is set out in the Investment Bank Special Administration Regulations 2011 issued by HM Treasury pursuant to section 233 of the Banking Act.

[19] “Condition 1 is that the bank is failing or likely to fail.
Condition 2 is that, having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the bank that will result in Condition 1 ceasing to be met.
Condition 3 is that the exercise of the power is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives.
Condition 4 is that one or more of the special resolution objectives would not be met to the same extent by the winding up of the bank (whether under Part 2 or otherwise).”

to provide for recapitalisation in insolvency. However, for firms of a certain size, the Bank judges that if they fail, recapitalising them with investors' funds and either allowing them to continue while they address the causes of their failure, or looking to transfer the firm to a private sector purchaser or a bridge bank, would likely be in the public interest as necessary for the advancement of, and proportionate to, one or more of the special resolution objectives, while winding up of the firm would not meet those special resolution objectives to the same extent. For these firms the Bank sets a higher MREL, usually at a level equal to twice the firm's minimum capital requirements. The effect of placing a firm into insolvency on its critical functions and deposits is explored in greater detail in the Bank's DP.

In order to guide the setting of individual firms' resolution strategies and therefore MRELs, the Bank set out in its Statement of Policy (last revised in 2018) thresholds for MREL above minimum capital requirements. They are indicative and they are structured as ranges (40,000 to 80,000 transactional accounts[20] for partial transfer strategies, and total assets of £15bn to £25bn for bail-in strategies) so that the Bank can apply a firm-specific judgment when applying the standards.[21]

At the point of 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 a 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.

In setting out the indicative thresholds, and making determinations of resolution strategies for individual firms, the Bank acts in accordance with its legal obligations as resolution authority. MREL must be set in line with the provisions of the Banking Act, the No. 2 Order and relevant binding technical standards, including the MREL UKTS. This means, for example, that the indicative thresholds for resolution strategies are different to the thresholds which the PRA uses, for example, to designate certain firms as 'other systematically important institutions' (O-SIIs), as the thresholds are set for different purposes.[22] Firms which do not meet the D-SIB criteria might still meet the threshold for resolution using stabilisation powers in the public interest if they should fail, even if they are not considered domestically systemically important.

Sufficient loss absorbing and recapitalisation capacity is critical to ensure a successful resolution. If a firm were to fail without it, the Bank may be unable to use its resolution powers effectively. The alternative of an insolvency process could have adverse consequences for depositors and for financial stability more broadly.

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[20] Transactional accounts are defined as accounts from which withdrawals have been made nine or more times within a three-month period.

[21] The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL), June 2018

[22] For more information, see Statement of Policy, The PRA's approach to identifying other systemically important institutions (O-SIIs), December 2020.

The Bank requires MREL for firms with a bail-in or partial transfer resolution strategy to be met in the form of statutorily or structurally subordinated resources, and in general MREL must be at least twice the firm's minimum capital requirements. This helps to ensure that there are sufficient resources to allow regulatory capital fully to absorb losses following a conservative valuation of the firm's assets, and to recapitalise the firm to a level sufficient to ensure that it meets minimum capital requirements and commands market confidence. This stabilisation is intended to allow for an orderly restructuring which addresses the root causes of the firm's failure.

It is therefore critical that the Bank sets resolution strategies and MRELs that are consistent with the execution of an orderly resolution in the public interest without recourse to public solvency support, in a sufficiently broad range of possible circumstances. As part of the MREL Review, the Bank has considered whether any factors or developments have altered since the introduction of both the legislative framework for resolution in the Banking Act, and the publication of the MREL Statement of Policy in 2016 (amended in 2018), that might change its risk assessment around this range of circumstances.

Proportionality and competition

The resolution regime is a key part of the post financial crisis reforms of the financial system. In setting resolution strategies, and MRELs, for individual firms, the Bank will continue to take into account the Bank's statutory objective to protect and enhance UK financial stability, as well as the special resolution objectives to which the authorities must have regard when using or considering the use of stabilisation powers and the Bank's general public law duties.

The UK resolution framework is set up by legislation to ensure full engagement between the Bank and PRA at key stages of an individual firm's life cycle, including in the determination of its MREL.[23] Although facilitating effective competition is not one of the Resolution Authority's statutory objectives, in producing the proposals set out in the CP and in finalising the changes to its policy, the Bank has consulted the PRA, which does have a secondary competition objective to facilitate effective competition in the markets for services provided by PRA regulated firms in carrying out regulated activities. Impacts on competition have therefore been considered in the Bank's assessment of the proportionality of its proposals.

Consistent with the PRA's secondary competition objective, a key principle of the PRA's approach to supervision is that it does not seek to operate a zero-failure regime for firms. Rather, and working with the Bank as resolution authority where required, the PRA seeks to ensure that any firms that fail do so in an orderly manner. As set out in the PRA's DP, 'A strong and simple prudential framework for non-systemic banks and building societies', the PRA considers that effective competition involves the least efficient firms being able to exit the market in an orderly way. The resolution regime, of which MREL is a key component, helps to ensure that this is possible in the event that it is not possible for the firm to exit via a solvent wind down or through a modified insolvency process.

[23] See Article 123(7) and Article 126(9) of the No.2 Order.

Having considered the challenges faced by mid-tier firms issuing MREL, as well as the responses to the CP, the Bank is making changes that will facilitate growth into MREL. Firms newly coming in scope of MREL exceeding capital requirements will benefit from a six-year stepped glide-path, with either one or two intermediate steps, and may request a flexible add-on should they need more time to reach their end-state MRELs.

Context and summary of changes to policy: the Bank's approach to the resolution strategy thresholds, calibration of MREL, MREL eligibility and intragroup MREL distribution

Box 1: Summary of changes and final policy

In finalising changes to our MREL policy, the Bank has taken into account the feedback provided in response to both the CP and our earlier DP.

Firms that may exceed the transactional accounts indicative threshold in the future:

- no change in transactional accounts indicative threshold;
- the Bank has initiated work in consultation with other authorities, the banking industry and other interested parties with a view to developing alternative processes that may reduce disruption to transactional accounts in the event of an insolvency procedure, which (depending on the outcomes) could in turn lead to the Bank raising or removing the transactional accounts threshold;
- the Bank will set a firm-specific resolution strategy with a 'notice period' in advance of the point in time (T) at which firms would need to start their transition to meeting MREL, as well as the transition glide-path;
- transition to be set on a firm-specific basis, taking into account relevant factors such as the firm's ability to access capital markets; and
- firms in transition will have the option of applying for a 'flexible add-on' of up to a further two years.

Firms that project to grow in size beyond £15bn total assets:

- no change to the indicative range for the total assets threshold of £15bn to £25bn total assets;

- the Bank will take into account firm-specific factors in setting a resolution strategy with a 'notice period' ordinarily expected to be a minimum of three years in advance of the point in time (T) at which firms would need to start their transition to meeting MREL, as well as the transition glide-path;
- the Bank will have the option to set, at its discretion on a firm-specific basis, either a three-step glide-path with steps of +33% of total capital requirements at T+2, +66% at T+4, with an end-state of +100% as proposed in the CP, or a two-step glide-path with MREL at +50% of total capital requirements at T+3 and +100% at T+6;
- in determining which glide path to apply the Bank will take into consideration representations made by firms; and
- firms in transition will have the option of applying for a 'flexible add-on' of up to a further two years.

Changes to the transactional accounts threshold: mitigating the risks of disruption in insolvency

As discussed in the CP, the Bank recognises that there have been market, technological, and consumer behaviour developments that may have a bearing on MREL policy: in particular the definition of transactional accounts for the purposes of the indicative threshold for partial transfer resolution strategies. This is in part due to the emergence of fintech firms and wider societal changes which have affected the structure of the UK banking system in the last few years.

In the DP, the Bank expressed its intention to assess whether the current definition of 'transactional accounts' accurately reflects the significance of an account from the perspective of the special resolution objectives. To that end, the Bank asked how it should update its definition of transactional accounts to take account of changes in market structure and customer behaviour.

As set out in the CP, under the current framework for depositor protection and preparedness for insolvency, the Bank considers that special resolution objectives would be unlikely to be met through the bank insolvency procedure (BIP) of a firm with a large number of transactional accounts. In particular covered depositors would suffer from:

- temporary lack of access to banking payment services i.e. the ability to make and receive payments;
- temporary lack of access to positive deposit balances with which to make payments; and

- permanent loss of associated account information e.g. payees, standing orders and direct debits, as well as payments history which can inform potential lenders' or creditors' credit decisions.

However, the Bank considers that recent innovations in technology in the banking system may afford opportunities to mitigate disruptions that may occur in the insolvency of a failing mid-tier firm whose business model is dominated by transactional account banking. These developments include Open Banking and 'linked accounts' technology.

The Bank has initiated work to be carried out in consultation with the banking industry, FSCS, FCA, PRA and other interested parties with a view to developing alternative processes which may reduce disruption to transactional accounts in the event of an insolvency procedure. Subject to the outcomes of this work, the Bank is considering whether it could significantly raise or remove the transactional accounts threshold. This work will take some time to complete and so the Bank does not envisage being able to make any consequential changes to resolution strategies and MRELs for individual firms before end-2022 at the very earliest.

Ahead of any prospective changes being made, the Bank confirms that:

- For firms that may exceed the transactional accounts indicative threshold in the future while the aforementioned review takes place, the Bank will make a firm-specific judgement when setting a resolution strategy. In doing so the Bank will consider a number of factors, including if the firm provides significant amounts of transactional banking services or other critical functions. The Bank will endeavour to engage with these firms as early as possible (including pre-authorisation where relevant) and, in line with the approach for firms planning to grow beyond £15bn assets, intends, based on information provided by firms, to provide firms as much advance notice as feasible (a 'notice period') of the point in time (T) at which they would need to start their transition to meeting MREL, as well as the transition glide-path. The length of the notice period for these firms may ultimately depend on a firm's transactional accounts growth rate. The Bank may decline to set T if it appears that a stabilisation powers resolution strategy is not likely to be required in the foreseeable future. In this case, the Bank may request that the firm revert to the Bank for a further assessment at a future point in time.

- Firms with a significant number of transactional accounts that are currently subject to a partial transfer resolution strategy will continue to be so.

- The transition for firms who have not yet begun their transition to meeting MREL will be set on a firm-specific basis, taking into account relevant factors such as the firm's ability to access capital markets. For firms growing into end-state MREL driven by the transactional accounts threshold, the Bank expects as a starting point to adopt a similar transitional approach as for firms who are growing into end-state MREL driven by the total assets threshold. This will include, when setting T and to the extent the Bank considers appropriate in each individual case, consideration of the same firm-specific factors set out below for consideration when the Bank is setting T for firms which project to grow in size beyond £15bn total assets.

- In addition, firms transitioning to an external MREL in excess of minimum capital requirements will have the option of applying for a 'flexible add-on' of up to a further two years. See below.

Changes to the total assets threshold: stepped glide-path approach for 'growing into MREL'

Summary

As set out in the CP, the Bank's assessment continues to be that above £15bn to 25bn total assets, a bail-in strategy that provides for the continuity of banking services is more likely to be appropriate. Respondents to the CP suggested the threshold could be raised significantly, noting international comparisons. The Bank considers that differences in the approaches of different jurisdictions may reflect local banking markets and the differences across jurisdictions in the plausibility of finding a willing buyer for a failing firm; the authorities' risk appetite for the disruption caused by insolvency; and the scope to use alternative sources of recapitalisation capacity, including the potential use of public funds.

Taking into account the special resolution objectives, and our practical experience of contingency planning, the Bank considers that entry into insolvency of a firm of that size would be unlikely to serve the public interest effectively, and MREL is therefore required to support a bail-in resolution strategy. Our judgement is that the insolvency of one or more mid-tier firms would be unlikely to meet the special resolution objectives (including, among others, protecting financial stability, ensuring the continuity of critical functions, protecting public funds and protecting deposits) to the same extent as the stabilisation options, and would cause an unacceptable level of disruption for banking customers and services and the wider economy, including a sharp fall in lending capacity.

As set out in the CP, the Bank is modifying its approach to setting MREL for firms which project to grow in size beyond £15bn total assets, and intends to provide as much advance notice as feasible to firms – a 'notice period' ordinarily expected to be a minimum of three years for firms planning to grow organically through the thresholds – of the point in time (T) at which they will need to start their transition to meeting MREL, as well as the transition glide-path. This does not mean that all firms will need to start building MREL as soon as they plan to grow past £15bn of total assets.

The CP set out that the Bank may set T as a point in time at or after the firm expects to surpass £15bn total assets, but would generally not expect to do so before it, other than in exceptional circumstances. The Bank may judge that an entry point to MREL which effectively exceeds £15bn total assets (but ordinarily not exceeding £25bn total assets) is appropriate in the circumstances.

In response to comments, the Bank is clarifying that, in setting T for any such firm, the Bank may consider the following factors:

- the firm's business model and its growth trajectory;
- the funding structure of the firm, including the balance between retail and wholesale funding;

- whether the firm provides critical economic functions, including the impact and substitutability of functions provided; and
- potential disruption caused by the insolvency of the firm.

In addition:

- in exceptional cases where a firm experiences growth far beyond its initial projections, such as following a merger or acquisition, the Bank may bring forward T to an earlier point in time; and

- firms which had not been set a T, but which exceed the £15bn to £25bn total assets threshold as a result of merger or acquisition, can expect to be set a T that may be less than three years in the future if the resulting firm is significantly above that threshold.

Determination of T will be a judgement for the Bank to exercise, taking into account the factors above to the extent the Bank considers appropriate in the individual case.

In light of responses to the CP, the Bank has revised its proposals on the 'stepped glide-path'.

The CP set out a stepped glide-path with increased transparency and predictability of requirements. As proposed in the CP, firms will have six years from the point at which their transition to end-state MREL begins to meet their end-state MREL in full, with two intermediate steps to reduce the scale of the cliff-edge.

In response to comments made by some respondents to the CP that the fixed steps of the proposed glide-path would force firms in the transition to issue debt at T+2 that is sub-benchmark in size, the Bank will have the option under the revised policy to set, at its discretion on a firm-specific basis, either a three-step glide-path with steps of +33% of total capital requirements at T+2, +66% at T+4, with an end-state of +100% as proposed in the CP, or a two-step glide-path with MREL at +50% of total capital requirements at T+3 and +100% at T+6. In determining which glide path to apply the Bank will take into consideration representations made by firms. This will support firms in looking to access the market less frequently but in larger, and therefore more economic, issuance amounts.

In addition, firms transitioning to an external MREL in excess of minimum capital requirements will have the option of applying for a 'flexible add-on' of up to a further two years (see below). In combination with the above changes, firms growing towards the total assets threshold should therefore have ordinarily at least three years' advance notice of when their transition to end-state MREL will start, and then between six to eight years to reach end-state MREL.

Flexible add-on

Firms (including those firms which have already received indicative interim and end-state MRELs in excess of minimum capital requirements) may request a maximum of two years of additional transition time, to be granted at the Bank's discretion. However, the Bank does not expect to grant the flexible add-on to firms who have met end-state MRELs, but will give due consideration to all requests received in light of the particular circumstances.

The up to two-year flexible add-on is made up of two elements and can be used in more than one block of time but may not exceed two years in total over the transition period:

- an element that firms may plan for or be aware of in advance – which they could bring to the Bank's attention for consideration whilst their issuance plan is being drawn up to support their transition path; and

- an element to respond to events that occur during the course of the transition for which firms should raise a request as outlined below.

In deciding whether or not to grant an add-on the Bank may consider:

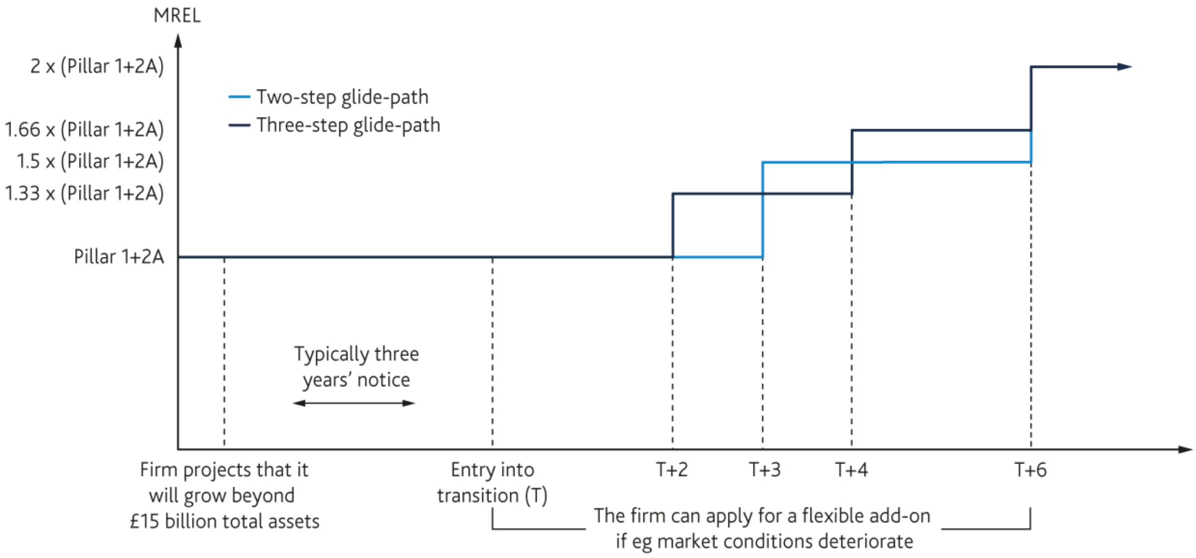
- whether the applicant firm had taken all steps and actions that were necessary (prior to any disruptive event occurring during the course of transition) to meet its target by the relevant deadline, including whether the firm has already benefitted from an add-on;

- whether there is market dislocation which impacts capital markets issuance conditions; and

- whether the firm's business model faces idiosyncratic challenges which justify an extension in the context of the Bank's legal obligations, including the Bank's statutory objective to protect and enhance UK financial stability and the obligation that the transitional period for a firm is as short as possible, as well as the special resolution objectives to which the authorities must have regard when using or considering the use of stabilisation powers.

These changes are summarised in Chart 1 below.

Chart 1: Transition for firms which project to grow in size beyond £15bn total assets



Case-by-case assessment

This document and the revised Statement of Policy relate to the Bank's general approach to setting MREL, and in particular how firms transition to meeting their end-state MREL. The Bank's general approach may need to take account of the circumstances of particular cases, reflecting the fact that MREL is an institution-specific requirement. For example, the Bank reserves the right, on an institution-specific basis, to set an earlier compliance date during the transition period for interim MRELs and/or end-state MRELs greater than capital requirements. For example where the Bank has concerns about the resolvability of a group or firm, or set a shorter notice period to T, if the firm is unable to provide the Bank with sufficient notice of when they expect to exceed the total assets or transactional accounts thresholds or in other exceptional circumstances. Once firms have met their end-state MRELs the Bank will continue to review regularly, and monitor their compliance with, their MRELs on an individual, case-by-case basis.

Calibration

As set out in the CP, after consideration, the Bank is not changing the basic calibration framework for MREL. MREL is key to achieving credible resolution and thereby the continuity of critical functions to the economy, reducing the social costs of firm failure. The calibration is designed to ensure firms have sufficient loss absorbing capacity (LAC) to support this. In concluding that changes would not be appropriate, we have re-examined how the MREL regime contributes to building up-front confidence that firms will have sufficient LAC.

Whereas the prudential regime is designed to reduce the probability of firm failure, the resolution regime is primarily a backstop focused on reducing the impact of failure. The MREL framework is therefore necessarily based on the assumption that a firm has failed, entered resolution, and so requires LAC sufficient to deliver continuity in a bail-in.

The Bank's approach as resolution authority is to avoid acting as a 'shadow supervisor' in setting MREL, for example by substituting its own judgement for that of the PRA. The MREL set by the Bank is therefore a function of:

- With respect to the loss absorption amount: the PRA's judgement on a firm's asset quality in its supervisory review that informs setting minimum capital requirements; and

- With respect to the recapitalisation amount: the PRA's judgement on the amount required to continue to authorise a firm in resolution with a level of capital that commands market confidence.

The current PRA risk appetite for continuing authorisation of firms immediately following resolution is based on minimum capital requirements as described in the FPC's December 2019 Financial Stability Report:

> Minimum capital requirements aim to ensure that banks can continue to operate, even after a stress, with an adequate layer of capital to protect depositors, maintain the confidence of markets and enable an orderly failure without losses to the taxpayer.

> When a bank does not have sufficient loss-absorbing capacity to meet these requirements, the PRA may judge it to have breached its 'Threshold Conditions'… Once minimum capital requirements have absorbed the losses made by a failed bank, the recapitalisation element of MREL is used to build the capital base of a resolved bank, so that it meets Threshold Conditions.

Since the publication of the Bank's CP, the FPC has finalised its direction to the PRA to implement (among other things) a minimum leverage ratio requirement for major UK firms and firms with significant non-UK assets, as set out in the FPC and PRA document 'The UK leverage ratio framework'.[24] For all other firms (including smaller firms), the PRA intends to set a revised supervisory expectation from 1 January 2022. As observed in 'Consultations by the FPC and PRA on changes to the UK leverage ratio framework'),[25] applying a supervisory expectation instead of a minimum requirement provides a more proportionate tool to mitigate the risk of excessive leverage for these firms. Importantly, in the PRA Supervisory Statement SS45/15 on The UK Leverage Ratio Framework,[26] effective from 1 January 2022, the PRA stated that there would be no automatic consequences for a firm that does not meet the leverage ratio supervisory expectation and that the expectation would not need to be met immediately following resolution.

MREL is set with reference to regulatory requirements, not supervisory expectations, and the Bank, as resolution authority, has confirmed to the PRA that it does not intend to propose changing this approach.

Would changing the FSCS funding model enable a change to MREL policy?

The FSCS is the UK's deposit guarantee scheme. It is currently funded in the main by annual levies on the banking industry (see Box 2). Some respondents to the CP suggested the FSCS could be 'pre-funded', as a better way to protect public funds in the event of a bank or building society insolvency. That is, levy-payers would be required to make a contribution to a centrally managed fund that would be built up to a certain level over a number of years and then replenished as necessary. In this way, the potential demand from the FSCS for an unexpected high levy or a loan from the National Loans Fund could be reduced. The Bank has considered these suggestions in finalising its revised MREL policy.

Pre-funding the FSCS would require legal changes and, given HM Treasury is responsible for designing the statutory framework within which the FSCS operates, this would be a matter for HM Treasury to consider. However, the Bank considers that – taking account of all factors relevant to determining the resolution strategy of a firm, including its special resolution objectives (see Figure 1) – it is unlikely that introduction of pre-funding for the FSCS would materially alter the Bank's judgment on which firms need to have a stabilisation powers resolution strategy and, therefore, be set an MREL in excess of minimum capital requirements.

[24] PS21/21 - The UK leverage ratio framework - the Leverage Review Response and Policy Statement, October 2021
[25] CP14/21 - Consultations by the FPC and PRA on changes to the UK leverage ratio framework, June 2021
[26] SS45/15 - The UK leverage ratio framework, October 2021.

Pre-funding, whatever its size, would not change the exposure of uncovered or ineligible depositors to loss in the event of a bank or building society failure, or enable banking services and critical functions to continue through insolvency. Compared to a stabilisation power resolution strategy, it would also not provide enhanced mitigation against potential contagion and instability within the financial sector or guard against a potential loss in confidence in bank deposits resulting from a bank insolvency.

Pre-funding might reduce risks to public funds but, in practice, these risks would not be eliminated in the event of a bank insolvency. Any pre-fund of material size would take a considerable amount of time to build up, and may not – even once its target level is reached – be sufficient to fully cover the pay out of all of a mid-tier firm's eligible deposits.

Importantly, the advance contributions to the pre-fund would reduce levy-payers' retained earnings, and therefore capital (all else equal). This means that there would be less capital to support lending to the real economy and to absorb losses, potentially reducing banking sector resilience. Particularly in the years that the fund is being built up, there would be increased burden on levy-payers: depending on how the levies were allocated, this could be a barrier to entry or growth within the sector. The fund would also require professional management, which would come at a cost.

The Bank has not considered the pre-funding suggestion beyond its impact on the firms and issues considered in the MREL Review, and the drawbacks identified do not necessarily apply to alternative potential models of FSCS funding.

Box 2: The Financial Services Compensation Scheme

Who is protected by the FSCS?

The Financial Services Compensation Scheme (the FSCS) is the UK's statutory scheme for compensating customers of certain failed financial services firms; stepping in to protect consumers when certain authorised financial services firms can't pay claims against them.

Eligible customer deposits held by banks, building societies and credit unions in UK establishments (hereafter 'firms') that are authorised by the PRA are protected by the FSCS up to £85,000 per customer.[27] Deposits covered in this way include, for example, eligible deposits in current accounts and savings accounts. Deposits made by certain institutions, such as financial institutions and large public authorities, are not eligible to

[27] A PRA-authorised firm may own several banking and building society brands. This means that anyone who has deposits in more than one account under a single brand, or multiple accounts under different brands owned by a single firm, is only protected up to a total of £85,000 across all these accounts. Joint accounts receive protection of £170,000, £85,000 per depositor. There is temporary deposit protection for up to 6 months above the £85,000 limit for certain types of deposits classified as temporary high balances, such as the proceeds from private property sales. Protection will be up to £1 million in most cases.

be covered.[28] The PRA is responsible for oversight of, and rules relating to, the FSCS in respect of deposit protection.

More information about the FSCS, including information about FSCS protection in other sectors, is available here.

How is an FSCS payout funded?

If a firm fails and enters an insolvency procedure (because, for example, it does not meet the public interest test for entry into the special resolution regime) the FSCS may effect a payout of eligible deposits.

The FSCS will seek to recoup costs from the rest of the banking industry through levies. Levies on the deposit-taking sector are currently limited to a maximum of £1.5bn per year set by PRA rules, and the actual amount of levies are set by the FSCS annually based on the FSCS's estimate of any compensation costs (taking into account likely recoveries) for that year. It also has access to a commercial borrowing facility of up to £1.5bn.

The FSCS may also under certain circumstances request from HM Treasury a loan from the National Loans Fund, such as if the demands on the FSCS exceed the amount of financial resources immediately available to it. Any such loan (and any interest on that loan) would then be repaid from levies on the industry and available recoveries from the failed firm.

The FSCS will ultimately seek to recover the costs incurred in a depositor payout from the insolvent estate of the firm concerned – a process which could take several years to complete. However, because the FSCS is a "super-preferred" creditor, it is amongst the first in line entitled to make recoveries.

Impact of proposals on existing mid-tier firms currently in scope of MREL in excess of minimum capital requirements

The deadline of 1 January 2023 (for those firms subject to it), to achieve the three resolvability outcomes under the Resolvability Assessment Framework remains in place.

Other than the option to apply for a flexible add-on, the changes to the glide-path will not directly affect the requirements for transitioning firms which have already been set indicative or actual interim or end-state MRELs in excess of minimum capital requirements. For these firms, interim and end-state MRELs will continue to be set without reference to the modified approach described in this statement. The Bank will consider the timing of the interim and end-state requirements for these firms, in light of the introduction of the six-year glide-path for firms newly growing beyond the thresholds. The Bank intends to disclose

[28] More information is available in the Eligibility Chapter of the Depositor Protection Part of the PRA Rulebook.

those firms' indicative and binding interim and end-state MRELs (including their timing) before the end of 2021.

Two respondents requested clarity on whether the 36-month transitional period to meet higher MRELs mentioned in the Bank's May 2020 statement would continue to apply, for example where firms which are not currently subject to a leverage-based capital requirement subsequently become subject to one resulting in a higher MREL.

The Bank confirms that the 36-month transitional period was intended to apply to a firm only if its MREL were to change materially as a result of changes to the scope of the UK leverage ratio framework following the outcome of the FPC and PRA's 2021 Leverage Ratio Review. It was not intended to apply to firms that 'grow in to leverage requirements'. The May 2020 statement on the Bank's website has been updated.[29]

However, as set out in the revised Statement of Policy, the Bank will continue to have discretion to set a further transitional MREL, if a firm so requests, for example to account for a change in regulatory requirements that affects MREL. In considering such a request, the Bank will take into account its broader financial stability objectives and public law duties including the legal requirement to keep the transition as short as possible.

Changes to the Bank's approach to MREL eligibility

In the CP the Bank reminded firms to consider whether having non-CET1 own funds instruments that do not meet the MREL eligibility criteria, as set out in Section 5 of the MREL Statement of Policy, could create difficulties for resolution.

The Bank also considered the MREL eligibility of non-CET1 own funds instruments issued from non-resolution entity subsidiaries to holders outside the group. The Financial Stability Board (FSB)'s TLAC standard provides that these instruments should not count towards external or internal TLAC from 1 January 2022. In 2018, the Bank indicated that the existence from 1 January 2022 of outstanding instruments that meet these criteria, and that are counted as MREL, may lead the Bank to set higher end-state MREL to compensate for those issuances.

In view of the challenges to resolvability presented by such instruments, the Bank is now confirming that, from 1 January 2022, non-CET1 own funds instruments issued from non-resolution entity UK subsidiaries to holders outside the group will in general no longer be eligible to count towards external or internal MREL.

The Bank will assess major UK firms' ability to achieve the three resolvability outcomes set out in the Bank's Statement of Policy on its Approach to Assessing Resolvability[30] during the first Resolvability Assessment Framework cycle. This will include how firms have assessed

[29] Please see https://www.bankofengland.co.uk/news/2020/may/statement-by-the-bank-of-england-and-pra-on-resolution-measures-and-covid-19. The Bank's statement of December 2020 has also been updated. Please see https://www.bankofengland.co.uk/news/2020/december/boe-statement-on-mrel-and-resolvability-deadlines.

[30] The Bank of England's Approach to Assessing Resolvability

risks to their resolvability posed by legacy capital instruments and any mitigating actions that firms have taken or propose to take.

Feedback to the CP suggested that the timing of the introduction of the revised policy on eligibility may give rise to specific difficulties for certain firms. In order to ensure appropriate proportionality, the Bank may, on firms' request, make temporary, time-limited adjustments as to how or when this policy change is implemented with respect to individual firms where to do so would not materially affect the overall amount of loss absorbing and recapitalisation capacity available in resolution.

The Bank's approach to intragroup MREL distribution

The Bank confirms that, as set out in the CP, it will leave its policy on intragroup MREL distribution unchanged. Consequently, only minimal changes are being made to the following sections of the MREL Statement of Policy:

Section 6 – MREL in the context of groups;
Section 7 – Internal MREL; and
Section 8 – Internal MREL instrument eligibility (except paragraph 8.6).

The Bank's policy on intragroup MREL distribution, including the sections listed above, was updated in June 2018. The Bank is continuing to work with overseas authorities to enhance cross-border resolvability to strengthen the effectiveness of Single-Point of Entry (SPE) resolution strategies. The Bank may consider its policy on intragroup MREL distribution in light of any progress in international engagement.

Impact assessment

The Bank first published a detailed impact assessment of its approach to setting MREL in 2015,[31] which was subsequently updated in 2017.[32] The Bank considers that the impact of its MREL policy would not fundamentally change as a result of its implementation of the revised approach set out in this document, compared to its assessments in 2015 and 2017. In particular the annual gross benefits associated with MREL, whilst difficult to quantify precisely and dependent on assumptions, are likely to continue to exceed the estimated macroeconomic costs of MREL by a considerable margin. In 2017, the Bank estimated that annual gross benefits associated with MREL were likely to be within a range from 0.3% to 0.9% of annual GDP, while macroeconomic costs of MREL were assessed to be around 0.02% of GDP.

Some respondents to the CP have pointed out that issuing additional loss-absorbing capacity comes at a considerable cost for them and limits their ability to lend further. The Bank acknowledges that the cost of MREL depends on market conditions and mid-tier firms may

31 Bank of England (2018), 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)', June 2018

32 Bank of England (2017), 'Internal MREL – the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) within groups, and further issues – Consultation on a proposed updated Statement of Policy', October 2017

face different challenges from large banks. Nevertheless, mid-tier firms have issued c.£3.2bn of MREL-eligible debt since 2018 and most have successfully issued MREL eligible liabilities with a coupon in the range of 1.5% to 3.0% in the last four years. By comparison, UK G-SIBs and D-SIBs have issued such liabilities with coupons in the range of 1.0% to 3.0%. Additionally, we estimate that issuing Additional Tier 1, Tier 2 and Eligible Liabilities instruments had a yearly cost of £30m-£40m per year for mid-tier firms, which is likely to be outweighed by the benefits associated with MREL.

Notwithstanding this, having considered the challenges outlined above faced by mid-tier firms issuing MREL, as well as the responses to the CP, the Bank is making changes that would facilitate growth into MREL. Firms newly coming in scope of MREL exceeding capital requirements will benefit from a six-year stepped glide-path. This proposal would not reduce mid-tier firms' end-state MRELs and, therefore, the Bank continues to estimate that the marginal cost to existing mid-tier firms of holding end-state MREL resources will be approximately £270m (2.3% of CET1).[33] All mid-tier firms may request a flexible add-on of a maximum of two additional years of transition time, should they need more time to reach their end-state MRELs.

Following respondents' feedback to the CP, the Bank is also introducing a two-step glide-path, as an alternative to the three step glide-path set out in the CP, to allow for more flexibility for growing firms. In particular, this is intended to address concerns that a three-step glide-path may, in some cases, require firms to issue sub-optimal amounts of MREL, which may come at a higher cost for them.

Consultation with HM Treasury

In line with the Memorandum of Understanding between the Bank and HM Treasury on Resolution Planning and Financial Crisis Management, HM Treasury has sole responsibility for any decision involving public funds.[34] In producing this Policy Statement the Bank has consulted HM Treasury. HM Treasury supports the Bank's revised approach to setting resolution strategies in the public interest, including the forward-looking total assets threshold above which the Bank would expect to consider setting a bail-in strategy. HM Treasury considers that the Bank's proposed changes to the framework for setting MREL should ensure that the Bank's MREL policy, including the calibration of end-state MREL, continues to provide an appropriate degree of protection of public funds while ensuring a proportionate approach for growing firms.

[33] This cost analysis depends on the counterfactual – how much own funds and eligible liabilities would firms hold in any event, if they were not subject to MREL in excess of minimum capital requirements. The costs may also vary between firms. Various regulatory factors, such as for example the Net Stable Funding Ratio (NSFR), and market-based factors (including the need to be resilient relative to large peers) may mean that firms would retain at least some additional MREL resources even if not required to do so by the Bank.

[34] Memorandum of understanding on resolution planning and financial crisis management, October 2017

Feedback on the Bank's July 2021 consultation

Background

In July 2021, the Bank published its CP as the second stage of the MREL review. The CP included a summary of the feedback received on the DP. The Bank received twenty formal responses, including from banks, building societies, industry associations, and advisory firms as well as extensive ad hoc engagement. The Bank would like to thank all respondents for their detailed and considered responses and active engagement in the consultation period. This section discusses the key themes from responses, and explains how the Bank has reflected the feedback in the Bank's revised policy.

Respondents to the CP provided feedback on the calibration of MREL, resolution strategy thresholds, instrument eligibility, and the application of MRELs within banking groups. Many respondents focused on the impact of MREL on mid-tier firms' growth and ability to compete with larger firms, with some arguing that MREL discourages mid-tiers from growing thus curtailing the supply of credit to the economy. To address these impacts, some respondents suggested that the calibration of MREL should be reduced for small, growing firms. Others proposed that the stepped glide-path be amended to account for the market constraints that mid-tier banks may face when issuing MREL resources. Questions were also raised about the criteria that the Bank will consider for granting a flexible add-on.

Other areas of focus included the Bank's work on alternative processes for reducing disruption to transactional accounts in an insolvency, with some respondents proposing that changes be made to the FSCS to deliver this outcome. Respondents also commented, amongst other things, on the complexity of the MREL framework and raised questions about MREL eligibility and MREL reporting. These points, and the Bank's responses to these points, are detailed below.

The Bank's revised policy reflects the Bank's careful consideration of respondents' feedback, as well as discussions with the PRA, the FCA, HM Treasury and the FSCS. The policy changes aim to strike a balance between addressing respondents' concerns and other stakeholder views, while still meeting the Bank's legal obligations. These include the Bank's statutory objective to protect and enhance UK financial stability, as well as the statutory objectives of the UK's special resolution regime to which the authorities must have regard when using or considering the use of stabilisation powers.

Feedback

Calibration

The CP set out that the calibration of MREL is dependent on whether the preferred resolution strategy for a firm is modified insolvency (insolvency), partial transfer or bail-in.

For firms with an insolvency resolution strategy, MREL is set at a level equal to minimum capital requirements. For mid-tier firms with a bail-in or partial transfer strategy, MREL is set at a level equal to twice their minimum capital requirements.[35]

Several respondents suggested that MREL should be reduced for small, growing firms. This suggestion was also made by some respondents to the DP.

The Bank considers that the calibration of the amount of end-state MREL remains appropriate. MREL needs to be sufficient to absorb losses and recapitalise the continuing business, in order to allow for an orderly and successful restructuring. The current calibration is designed to ensure that firms have the resources to support this.

The stepped glide-path

Two respondents commented that the fixed steps of the proposed glide-path would force firms in the transition to issue debt at T+2 that is sub-benchmark in size.

In response, the Bank has included in the revised policy an option to set, at its discretion and on an institution-specific basis, either a three-step glide-path with steps after two years and four years as proposed in the CP, or a two-step glide-path with MREL (in addition to minimum capital requirements) at 50% at T+3 and 100% at T+6. This is intended to support firms in looking to access the market less frequently but for larger, and therefore more economic, issuance amounts, while leaving the overall level of risk to the Bank's statutory objectives approximately unchanged in that the increased risk in Year 3 would be offset by decreased risk in Year 4.

The flexible add-on

Several respondents requested more clarity regarding the criteria the Bank will consider when granting the flexible add-on. The Bank can confirm that firms set an external MREL in excess of minimum capital requirements will be able to apply for a 'flexible add-on' of up to a further two years should market conditions or other circumstances warrant an extension. Granting any add-on will be at the Bank's discretion acting in accordance with its legal obligations, including the obligation that the transitional period for a firm is as short as possible.

A few respondents noted that firms with evolving business models may meet end-state MREL and subsequently fall below it because of an increase in risk weighted assets or expenditure of capital. Other respondents said that they could face difficulties refinancing eligible liabilities in the market in adverse market circumstances and asked for greater flexibility while growing into MREL.

In response to these comments, the Bank is clarifying that, whilst it does not generally expect to grant the add-on to firms that have already met their end-state MRELs, this remains a firm-specific decision. Firms that consider that their circumstances make them eligible for an add-on should discuss this with the Bank.

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[35] This may be adjusted for partial transfer to reflect the firm's resolution strategy.

Some respondents also pointed out that disclosure obligations applying to them may dissuade them from applying for an add-on, should their circumstances warrant it. The Bank notes the respondents' concerns, but believes that the add-on may still be beneficial for firms in certain circumstances. The Bank is therefore not proposing to change the approach set out in the CP.

Further transitional MRELs

Two respondents requested clarity on whether the 36-month transitional period to meet higher MRELs mentioned in the Bank's May 2020 statement would continue to apply, for example where firms which are not currently subject to a leverage-based capital requirement subsequently become subject to one resulting in a higher MREL.

In response, the Bank confirms that the 36-month transitional period referred to in the Bank's May 2020 notice was intended to apply to a firm only if its MREL were to change materially as a result of changes to the scope of the UK leverage ratio framework following the outcome of the FPC and PRA's 2021 Leverage Ratio Review. It was not intended to apply to firms that 'grow in to leverage requirements'. The May 2020 statement on the Bank's website has been updated. However, as set out in the revised Statement of Policy, the Bank will continue to have discretion to set a further transitional MREL, including the appropriate transitional period, if a firm so requests, for example to account for adverse market circumstances. In considering such a request, the Bank will take into account its broader financial stability objectives and public law duties including the legal requirement to keep the transition as short as possible.

The impact of MREL on competition and lending

Several respondents argued that the Bank's approach to setting MREL results in a competitive disadvantage for mid-tier firms. The CP respondents argued that the current MREL framework discourages the growth aspirations of these firms and has an impact on the supply of credit they provide to the economy. A number of respondents highlighted an EY study that estimates that MREL results in foregone lending profitability for mid-tier firms.[36] Several respondents noted the potential increase in MREL when moving to a partial transfer or bail-in strategy and others requested a longer transition period to give growing firms sufficient time to establish themselves in the debt market and address future refinancing risk.

The Bank's final policy takes into account some of the challenges faced by mid-tier firms. For example, the final policy provides for a longer transition period to meet MREL, more flexibility on that transition period, and a lengthy period of notice (ordinarily three years) as to when firms become subject to MREL. The Bank has set out further information on the rationale for these changes in chapter 2 of this document.

Competition objective

One respondent suggested that the Bank, as resolution authority, should have a competition objective for consistency with the PRA's secondary competition objective. This suggestion was also made by some respondents to the DP.

[36] https://www.ey.com/en_uk/banking-capital-markets/how-mid-tier-banks-could-be-impacted-by-new-safety-rules.

The statutory objectives of the UK's special resolution regime are set out in the Banking Act in the form of the special resolution objectives. The PRA's general objectives are set out in the Financial Services and Markets Act 2000, including a secondary objective to facilitate effective competition in the markets for services provided by PRA-authorised firms in carrying out regulated activities. As a public authority the Bank is also under general public law duties governing the actions of public bodies. The UK resolution framework is set up by legislation to ensure full engagement between the Bank and PRA, at key stages of an individual firm's life cycle, including in the determination of its MREL.[37] Impacts on competition are therefore considered in the Bank's assessment of the proportionality of its proposals and the Bank aims to ensure that the policy benefits derived from the requirements it sets are proportionate to the costs or burden placed on firms.

Any changes to the statutory framework governing the Bank as a resolution authority would be a matter for HM Government and Parliament to consider, and as such would be outside the scope of the Bank's MREL Review.

Streamlining the MREL framework

Respondents raised concerns that the interaction of various requirements set out across UK CRR, the MREL Statement of Policy and PRA supervisory statements creates inconsistency and confusion that needs to be addressed. The Bank does not consider it to be feasible at this time to achieve significant streamlining of the MREL framework purely through changes to the Statement of Policy because of dependencies on other legal texts. However, the Bank will consider opportunities that may arise for streamlining in future through, among other changes, further amendments to the Statement of Policy

One respondent commented that the PRA's recent decision to consider allowing firms to apply for the application of the leverage ratio at an individual level to be replaced with a sub-consolidated requirement where a firm has subsidiaries that can be consolidated, [38] should be extended to MREL. The Bank notes that its MREL calibration generally mirrors capital requirements set by the PRA. However, in addition to MRELs set by the Bank in line with its Statement of Policy and the FSB's TLAC standard, firms that are G-SIBs or material subsidiaries of non-UK G-SIBs, remain subject to requirements for own funds and eligible liabilities set by the UK CRR which, in aggregate, may result in an outcome that may not be entirely aligned to the minimum capital requirements set by the PRA. The Bank is therefore not proposing to change its approach.

Indicative thresholds

Several respondents requested greater transparency around the timeline of the work to be carried out on alternative processes which may reduce disruption to transactional accounts in the event of an insolvency procedure and any short-term effects on partial transfer firms. This work will take some time to complete and so the Bank does not envisage being able to make any consequential changes to resolution strategies and MRELs for individual firms

[37] See Article 123(7) and Article 126(9) of the No.2 Order.
[38] SS45/15 - The UK leverage ratio framework, October 2021

before end-2022 at the earliest. The Bank is cognisant of the potential impact on firms and will communicate interim and end-state MRELs to firms affected by this work in due course.

Several respondents requested that the indicative total assets threshold for bail-in be raised to mirror other thresholds in the prudential regime, such as the leverage ratio framework or the ring-fencing regime. The Bank, however, considers it appropriate that its indicative thresholds differ from other regulatory thresholds, as the thresholds are set for different purposes. This difference reflects that the special resolution objectives are different to the objectives underpinning other parts of the framework, such as the FPC's objectives[39] and the PRA's objectives[40] in relation to the leverage ratio framework.

Changes to the FSCS

Several respondents suggested that a fundamental review of the FSCS, including its funding model and deposit coverage, should be prioritised and completed in the medium-term. Respondents suggested that an approach with pre-funding, and increased coverage to deposits above £85,000, would result in lower risks to the use of public funds during the insolvency of a firm, which in turn might allow the total assets indicative threshold in the UK to be raised to £50bn or to a level closer to some international comparisons.

As mentioned above, the Bank has initiated work to be carried out in consultation with the banking industry, FSCS, FCA, PRA and other interested parties with a view to developing alternative processes which may reduce disruption to transactional accounts in the event of an insolvency procedure. Subject to the outcomes of this work, the Bank is considering whether it could significantly raise or remove the transactional accounts threshold. This work will take some time to complete and so the Bank does not envisage being able to make any consequential changes to resolution strategies and MRELs for individual firms before end-2022 at the very earliest.

As set out above, the Bank considers that – taking account of all factors relevant to determining the resolution strategy of a firm, including its special resolution objectives (see Figure 1) – it is unlikely that introduction of pre-funding for the FSCS would materially alter the Bank's judgment on which firms need to have a stabilisation powers resolution strategy and, therefore, be set an MREL in excess of minimum capital requirements.

Pre-funding, whatever its size, would not change the exposure of uncovered or ineligible depositors to loss in the event of a bank or building society failure, or enable banking services and critical functions to continue through insolvency. Compared to a stabilisation power resolution strategy, it would also not provide enhanced mitigation against potential contagion and instability within the financial sector or guard against a potential loss in confidence in bank deposits resulting from a bank insolvency.

[39] Contributing to the Bank's objective to protect and enhance the stability of the UK financial system (primarily by identifying, monitoring and acting to remove or reduce risks to the stability of the whole or significant part of that system, with a view to protecting the resilience of that system) and, subject to that, supporting the economic policy of the Government, including its objectives for growth and employment.

[40] A general objective to promote the safety and soundness of the firms it regulates, focusing on the adverse effects that they can have on the stability of the UK financial system. A secondary objective to facilitate effective competition in the markets for services provided by PRA-authorised firms.

Pre-funding might reduce risks to public funds but, in practice, these risks would not be eliminated in the event of a bank insolvency. Any pre-fund of material size would take a considerable amount of time to build up, and may not – even once its target level is reached – be sufficient to fully cover the pay out of all of a mid-tier firm's eligible deposits.

We have set out further information on the FSCS in Box 2.

MREL eligibility

One respondent questioned whether the ineligibility to count towards MREL of own funds instruments issued externally from non-resolution entities would affect the MREL-eligibility of legacy capital instruments issued from building societies' resolution entities. The Bank confirms that this ground of ineligibility will not apply to legacy capital instruments issued from firms' resolution entities including those of building societies. However, the eligibility of these instruments to count towards MREL depends on whether they meet the wider set of MREL eligibility criteria set out in the MREL Statement of Policy. The Bank considers that the responsibility for ensuring that liabilities, including own funds instruments, are eligible as MREL rests with firms. The Bank is not proposing any changes to this approach. The Bank reminds firms that they are expected to be able to demonstrate compliance with the eligibility criteria on request in line with the continuous resolvability assessment process and, where relevant, the Resolvability Assessment Framework.

One respondent asserted that there is no need for contractual triggers in internal MREL instruments following the recent expansion of the Bank's 'PONV' write-down powers in the Banking Act.[41] While these changes do provide the Bank with the power to write-down or convert eligible liabilities in certain circumstances, they do not provide as much flexibility as contractual triggers. Contractual triggers in internal MREL instruments are an important part of ensuring that internal MREL will be available in some resolution contexts, such as in the case of a material subsidiary where the related resolution entity is in resolution, and help to align home and host authority incentives. Given these benefits, we do not propose to amend the policy.

The Bank received comments from two respondents that firms transitioning to a simple single-HoldCo/single-OpCo structure on becoming a bail-in firm should be granted relief by the Bank for the consequences of previously OpCo-issued instruments being excluded from MREL.

The Bank notes that this issue should arise only if a firm has issued MREL instruments at OpCo level that are not able easily to be migrated up to the new HoldCo, and encourages all firms that might be affected to include in their instruments the legal language necessary to facilitate the migration.

However, these responses suggested that the timing of the introduction of the revised policy on eligibility may give rise to specific difficulties for certain firms. In order to ensure

[41] Mandatory write-down, conversion etc of capital instruments and certain liabilities under sections 6A-6D and 81AA of the Banking Act.

appropriate proportionality, the Bank may on firms' request make temporary, time-limited adjustments as to how or when this policy change is implemented with respect to individual firms where to do so would not materially affect the overall amount of loss absorbing and recapitalisation capacity available in resolution.

MREL reporting

One firm sought clarity on whether the existing MREL reporting requirements will continue to apply and whether any new reporting requirements will be introduced. Consistent with the CP, we do not intend to make any changes to the existing reporting requirements nor to introduce new requirements.

Comparison with international standards

Several respondents noted that the UK's indicative thresholds were lower than those in other jurisdictions, thereby creating a disadvantage for UK-based firms. Respondents noted that, in the US, the requirement to have recapitalisation capacity applies only to US G-SIBs and the US operations of the largest and most systemic foreign banking organisations. In the European Banking Union, the threshold is set at €100bn.

The Bank considers that differences in the approaches of different jurisdictions may reflect local banking markets and the differences across jurisdictions in the plausibility of finding a willing buyer for a failing firm; the authorities' risk appetite for the disruption caused by insolvency; and the scope to use alternative sources of recapitalisation capacity, including the potential use of public funds. The Bank provided a detailed international comparison on thresholds in Box 3 of the DP.

Equality and diversity

The Bank noted in the CP that it considered that its proposals did not give rise to equality or diversity implications.

The Bank did not receive any comments from respondents in respect of the proposals having equality or diversity implications.

Annex

1 Statement of Policy on the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)

Available at: https://www.bankofengland.co.uk/paper/2021/the-boes-approach-to-setting-mrel-sop