BSA Response to MREL Consultation

Restatement of CRR

January 2025

Building Societies Association

Summary

The Building Societies Association (BSA) represents all 42 UK building societies, including both mutual-owned banks, as well as 7 credit unions. Building societies have total assets of almost £525 billion and together with their subsidiaries, hold residential mortgages of over £395 billion, 24% of the total outstanding in the UK. They also hold £399 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for 40% of all cash ISA balances. They employ around 52,300 full and part-time staff and operate through approximately 1,300 branches, a 30% share of branches across the UK.

The BSA welcomes the opportunity to comment on the proposals in the MREL consultation, published by the Bank of England (BoE) on 15th October 2024.[1] As a general principle, the BSA supports the transfer of rules that were previously part of the Capital Requirements Regulation (CRR) across to the PRA and BoE, or in this case into MREL SoP. We believe it is appropriate and pragmatic for the detailed rules to be under the control of the PRA or BoE. This allows for the timely updating of the rules to keep pace with market developments, with the safeguards of open consultation and cost-benefit-analysis for any changes. We encourage the BoE to look for opportunities to make refinements at the same time as bringing the rules into the PRA Rulebook, both in terms of substance and improving proportionality where appropriate, but also in terms of reducing ambiguity and improving the readability of the requirements.

We note that MREL policy is set by the BoE Resolution Directorate which is not subject to the same secondary competition, competitiveness and growth objectives as the PRA. We do not believe that the application of MREL to mid-tier firms is proportionate to the risks posed by a mid-tier building society to the BoE's objectives if it were to fail. Now that the UK has exited the EU, we would like to pose the fundamental question of why MREL requirements are applied at all to non-systemic firms in the UK? At the international level, TLAC requirements only apply to G-SIBs. We believe the cost-benefit-analysis related to this consultation should clearly cover this fundamental question of the costs and benefits of applying TLAC to both domestic systemic firms (D-SIBs) and certain non-systemic mid-tiers. This analysis is currently missing from the consultation which takes the starting point of the status quo. MREL is an EU-only construct. Now is an appropriate time to challenge the scope of application of TLAC to mid-tier domestic firms in the UK, that are neither systemic nor internationally active, and specifically to very low-risk mutual business models such as building societies.

As the requirements currently stand, the only difference between the resolvability requirements for firms >£50bn and a smaller firm of £15-25bn is the requirement to make public disclosures. We do not believe that requiring firms to meet the same rules is a proportionate approach, and it is illogical to apply the same rules designed for a G-SIB to a domestic regional mid-tier building society. It is not enough to simply ask a firm to apply the rules in a more proportionate way without guidance on what that might mean i.e. areas where less attention is required or where reliance can be placed on other processes. Building societies tend to have a conservative approach towards compliance with

[1] It might be easier in future consultations for the Bank of England to use a numbering system for its consultation documents

regulations and it is therefore difficult to see any proportionality in the current requirements which adopt a one-size-fits-all approach (with the exception of public disclosures noted above).

In terms of the thresholds, we propose that the BoE works with the PRA to conduct a more holistic review of all of the thresholds across the regulatory framework. The BSA set out its views in our response to CP12/24, but we repeat them here for ease. While we welcome the proposals to increase certain thresholds, we do not believe the BoE has gone far enough with the proposals in this MREL consultation. We believe that the current £15-25bn threshold should be increased by more than £5bn to take some of the mid-tier societies out of scope. Balance sheet size is not an indicator of the probability nor the impact of failure, and mid-tier societies do not provide critical services.

We also propose that the 40,000-80,000 threshold on transactional accounts is increased very significantly to at least a million accounts, to allow for more competition and growth in the current account market, without the threat of becoming subject to MREL requirements. Fundamentally we think the BoE and PRA should set out high level principles to demonstrate how they will review thresholds in the future to give firms a degree of predictability around how thresholds will increase in future, particularly for firms that are not systemic, not internationally active and unlikely to become systemic any time soon.

Scope of application, thresholds and proportionality of requirements

The BoE's proposals explain that the thresholds are indicative. This means that if crossed, the BoE will conduct an assessment to determine whether a stabilisation preferred resolution is required. The BSA supports that thresholds are indicative rather than mechanical. However, we would like to point out that indicative limits still restrain firms that do not want to be subject to MREL because the issuance of MREL for them would have very profound consequences to their cost base, ability to be compliant with such requirements and therefore the sustainability of their business model more generally. As such, the only prudent way for any firm to ensure that they are not required to hold MREL is to manage the business to stay below those stated thresholds. So, while the thresholds are indicative, they do have a real world impact on the choices firms make and the BoE needs to be mindful of this unintended consequence that constrains growth.

As mentioned above, while any increase in the balance sheet size threshold is welcome, we do not believe the increase goes far enough. The PRA's strong and simple consultation (CP7/24) asks for suggestions on potential simplifications in the regime applied to mid-tier firms that are too large to qualify for the SDDT regime but that are neither domestically systemic nor internationally active. The BSA is of the view that the MREL regime is an area that is not currently proportionate for this group of firms. So, rather than reviewing and increasing the current threshold to account merely for inflation, we would propose that the BoE conducts a first principles review of whether it is really necessary and appropriate for mid-tier firms to be subject to MREL, including a detailed cost-benefit-analysis. Therefore, a better approach might be to increase the indicative threshold to £50bn. In addition, the BoE could be clearer on what factors it takes into account when making an assessment of a firm above

the threshold, such as the probability and impact of that firm's failure and which critical services, if any, are offered. We also note that the BoE has said that it does not expect to increase the threshold frequently. We oppose this approach. The regulators are required under FSMA to ensure that their rulebooks remain fit for purpose over time. As such we believe that all the thresholds in the rulebook should be reviewed and confirmed or updated regularly. We also believe that the BoE should be clearer on how it has set the threshold and why it remains relevant, including how it has taken the risk[2] of the firm into account as well as the size. The impact on firms of crossing such thresholds is very significant and the BoE should be mindful to avoid 'prudential drag' whereby firms are captured over time without posing any increased risk to the regulators' objectives. This prohibits competitiveness and growth if firms are artificially managing their business to stay below thresholds.

As a point of detail, we note the requirement in paragraph 9.7 of the MREL SoP for firms to notify the BoE when they are forecasting to exceed the lower bound of the threshold range. We think it would be better to include this monitoring requirement under the SDDT regime. That way the scope of the SoP could then become all banks of building societies above the threshold rather than all banks and building societies. It is not proportionate for smaller SDDT firms to be required to review the whole SoP just to locate the monitoring requirement within paragraph 9.7. That would sit better elsewhere in the regulatory framework such that it is not missed nor do smaller firms have to review documents that are largely irrelevant to them.

We believe that the calibration of the second threshold on transactional accounts is inconsistent with supporting growth and competition. Building societies have been strong supporters of local communities by maintaining their branch networks at a time when many banks are withdrawing. This means there is a business opportunity for smaller firms to offer more of those products, where the banks are withdrawing their local presence. As such, we believe the 40,000-80,000 threshold is significantly and prohibitively too low. While we understand the rationale for using transactional accounts as a measure of the systemic importance of a firm, this needs to be weighed against the value of encouraging more competition for current accounts which is a good thing for broader financial stability and competition.[3] As such any growth to smaller players should be encouraged rather than disincentivised. We propose that the threshold should be in the region of at least one million transactional accounts. The current calibration means that a UK SDDT firm well under the size threshold and proactively identified by the PRA as non-systemic could be captured under MREL. We think that any firm qualifying for SDDT should by default be outside of the scope of MREL, as well as a number of mid-tier firms too.

We note that the BoE has considered the number of transactional accounts at Silicon Valley Bank (SVB) which was below 40,000 in the UK and taken that as an indicator that, if anything, the threshold is too low. While we support that the BoE has reflected extensively on the failure of SVB, we do not believe that all future policy should be calibrated to SVB, which was a unique situation, serving a niche market, and its failure in the UK was largely a result of problems at the parent entity in the US. Inevitably a

[2] The probability of failure of a 150yr old low-risk building society is not the same as a fast growing challenger bank of the same size and this should be taken into account

[3] The FCA has taken various steps to improve competition in current accounts in response to the CMA report on the effectiveness of competition in the retail banking market in 2016, such as introducing the 7-day current account switching service.

bank that served business clients will have fewer customers than any provider of retail transactional accounts and this is an important difference which we believe has resulted in a miscalibration.

Deduction of holdings of MREL

The BSA understands the theory of applying a deduction approach to holdings of G-SIB's TLAC. However, in practice, mid-tier societies do not hold significant levels of such instruments as set out in the BoE's CBA. As such we question the value and proportionality in introducing a requirement that generates compliance work for societies and potentially IT changes but without generating much benefit in terms of increased financial stability. The PRA's SDDT proposals take the approach that where a risk isn't particularly relevant for a firm, then those requirements are removed e.g. for counterparty credit risk and CVA. We propose that the BoE could follow a similar philosophy for mid-tier firms that currently do not have significant holdings of G-SIB's MREL and are unlikely to do so in the future. We feel the proposals are quite purist in trying to mitigate a future risk that could theoretically occur, but in practice is quite unlikely. As such, we question the proposed deductions approach to holdings of G-SIB's TLAC which add cost and complexity without demonstrably adding much in the way of increased resilience.

We believe there is a bigger potential systemic risk currently with credit unions that hold much of their liquidity with a clearing bank that may be a G-SIB and in accounts that may be subject to bail-in.[4] While credit unions are neither systemic individually nor collectively, they do provide extremely important services in the UK, and any contagion reputational impacts from the failure of a G-SIB to the credit union sector should clearly be avoided. One simple solution to this is to allow larger credit unions access to BoE liquidity facilities to allow them the tools to reduce their exposures to G-SIBs and other firms that may be subject to bail-in[5] thereby spreading their counterparty risk.

Legal opinions

We note the clarifications included in the consultation that legal opinions are required for each issuance of MREL. While we understand the need to have certainty and to guard against any legal challenges during bail-in, we do not feel the current proposals are proportionate to the risk.

Mid-tier societies often meet MREL requirements with regulatory capital such as CET1, AT1 and T2. If this is the case and then there should be no additional requirement for a separate legal opinion to confirm eligibility for MREL. We ask that the BoE clarifies that qualifying capital instruments are not required to gain an additional separate legal opinion to confirm that they also comply with the requirements for MREL.

We would also challenge the situation where a mid-tier society issues additional MREL that is identical to previous issuances, whether it is proportionate to require a new legal opinion, and whether the benefits would outweigh the costs. The answer to this might be different depending on the situation of the firm, and whether it was in a crisis situation and close to resolution. The PRA and BoE would

[4] While we understand that the BoE has tools to exempt certain exposures from bail-in, these are untested and add additional complexity to the already extremely complex process of operationalising a bail-in

[5] The BSA first raised this request for credit unions to have access to BoE facilities in 2021

have all the supervisory tools necessary to deal with such situations on a case-by-case basis if they had doubts on the eligibility of MREL instruments for a particular firm, which would seem a more proportionate approach than requiring duplication of legal opinions in normal times.

The consultation states the view that the cost of such legal opinions is unlikely to be material in the context of issuance more generally. The BSA opposes this view. The cost of a legal opinion is likely to be similar regardless of the size of the issuance. Therefore, a mid-tier firm issuing a smaller amount of MREL will be proportionately impacted more than a larger firm conducting larger issuances. This does not appear to have been factored into the BoE's thinking in drawing this conclusion. Furthermore, general issuances costs are proportionately higher for smaller firms and attract a lower credit rating due to their size.

Finally, we note that 5.11 of the revised SoP only applies to new issuances intended to be used as MREL. Can the BoE confirm that this requirement does not extend to existing issuances?

Responses to questions

Q1. Do you agree that the Bank's proposals for consolidating and unifying the existing eligibility regimes in the MREL SoP would provide benefits in terms of simplification and greater clarity, without significantly increasing the burden on firms in practice?

Yes, the BSA supports consolidating and unifying the requirements into one place in the MREL SoP.

Q2. Given that firms would continue to be responsible for ensuring that liabilities and instruments are eligible for MREL, do you agree the proposed revised MREL SoP would provide sufficient information for firms on eligibility?

Notwithstanding our responses to other questions, we generally support including the MREL requirements all in one place in the MREL SoP. However, for non-MREL firms we believe that the requirement to monitor if they get close to the indicative limits would be better also included in the SDDT framework to avoid smaller firms needing to review the detailed requirements in the SoP that are largely irrelevant.

Q3. Do you agree with the proposed scope of the deductions regime and that the impact in practice on firms would be limited?

No. While the BSA understands the theoretical logic, we do not support the new deduction requirements as proposed for the reasons set out above. The requirements add cost and complexity without providing benefits, if applied to mid-tier societies that are neither systemic nor internationally active. We call for the BoE to mirror the philosophy underpinning the proportionate proposals under SDDT where requirements are not generally imposed if unlikely to be relevant. This is because implementing requirements still require compliance resources and potentially IT systems changes for work that is ultimately of limited value. The PRA and BoE have other supervisory tools to use if a mid-tier were to become overly exposed to TLAC holdings such as Pillar 2.

Q4. Do you agree with the Bank ceasing to maintain a general prior permissions process for redemptions and reductions of G-SIB issued ELIs, and the clarification of when all firms should seek permission from the Bank for redemptions or reductions of ELIs?

Yes, the BSA supports these proposals. There are other mechanisms, such as the requirement under the Senior Managers and Certification Regime for individuals to take reasonable steps and be accountable for compliance with the BoE rules. Therefore, we believe that the ultimate aim of the existing requirements will likely already be met without the additional requirement of permission from the BoE.

Q5. As regards both contractual triggers for iMREL instruments and other expectations for non-CET1 own funds instruments, are there material implications arising from the proposed policy changes for non-CET1 own funds instruments, beyond those that also apply with respect to ELIs?

The BSA is not currently commenting on this question given that only two societies will be impacted by the changes as a result of very recent acquisitions. It is therefore too soon for us to form any sectoral view on these proposals.

Q6. Do you agree with the Bank's proposed approach to updating its indicative total assets threshold for setting a bail-in preferred resolution strategy?

No, we do not support the proposals. While any increase in the limit is better than no increase, we do not believe the proposals go far enough, nor do we agree that balance sheet size alone is the right measure. It would be better for the BoE to consider factors such as the probability and impact of a firm's failure and whether it is offering critical services, in addition to balance sheet size. We also request a more holistic approach to all thresholds rather than piecemeal individual changes as set out above. We believe the BoE/PRA should regularly review all thresholds and set principles to give more certainty to firms on how the thresholds might change over time.

Q7. Do you agree with the Bank's proposed approach to its indicative transactional accounts threshold and amendments to setting MREL for firms with transfer as their preferred resolution strategy?

No, we do not support the retention of the 40,000-80,000 transactional accounts threshold. This limit is anti-competitive and constraining growth of the provision of services to customers who have faced multiple bank branch closures and where building societies are the only presence in many provincial towns. While we understand the logic of using transactional accounts as an indicator of systemic importance, it should be increased to at least a million. The BSA believes that the BoE/PRA should review all thresholds regularly and set principles to give more certainty to firms on how the thresholds might change over time.

In relation to the setting of the level of MREL for transfer preferred strategy firms, (noting our comments above in relation to effectively calibrating which firms this should be), we support the amendments proposed; namely the targeted change such that MREL would generally be expected to be set as equal to MCR.

Q8. Do you agree with the Bank's rationale for adopting accounting value as the appropriate measurement basis for eligible liabilities? Are there other considerations which may have a material impact on firms that the Bank should consider before finalising its approach?

The proposal for adopting accounting valuation creates volatility. The consultation acknowledges this volatility may become far more material than implied if it was modelled in stress testing or if an actual stress occurred where interest rates move significantly. This procyclical volatility could drive MREL deterioration right when CET1 might be under pressure in a stress, putting a larger burden on firms. This would encourage holding more MREL in normal conditions to cover the potential decline in value, which will impact the cost of carry. Any resulting requirement to hold more MREL in normal times is proportionately more burdensome for smaller firms that have fewer MREL issuances. This is a complex area and these second-order effects need careful consideration. The worked examples should also consider the impact of issuing MREL in different currencies.

Q9. Do you agree with the proposed clarifications to the Bank's expectations regarding provision of legal advice and maintenance of effective internal processes relating to instrument eligibility and regulatory reporting?

No, as set out above we believe the requirements are not proportionate to the risks posed. Mid-tier firms will have proportionately higher costs in meeting MREL requirements in general due to a number of factors not reflective of risks to the BoE's objectives. For example, lower credit rating, low ticket size of issuance, less frequent issuance, greater impact on internal compliance staff, in addition to the cost of legal opinions. Together all these factors mean the cost of additional legal opinions is a significant cost that should not be underestimated. We do not agree with the BoE's CBA view that the costs are not material.

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of almost £525 billion, and account for 24% of the UK mortgage market and 19% of the UK savings market.