Association for Financial Markets in Europe

The Bank of England's review of its approach to setting MREL

AFME consultation response

1 October 2021

Introduction

AFME[1] welcomes the opportunity to comment on the Bank of England's review of MREL, published on 22 July 2021.

AFME has long supported the implementation of MREL as part of putting in place effective and credible resolution plans that enable banks to be resolved without systemic disruption or exposing taxpayers to loss. We believe that much progress has been made to date, such that firms and authorities are now much more prepared for a resolution event than at any time in history. MREL plays an important role in achieving this.

We welcome the Bank of England's review of its approach to setting MREL and its amended statement of policy. We agree with the approach the Bank of England has been taking on MREL, and the proposals within the review. It is vital that a proportionate approach is taken to ensure all banks providing critical functions, regardless of size, are prepared adequately for their own failure.

There are however two areas where we feel action is required by the UK authorities, and this regards the approach to calibrating and structuring internal MREL per the requirements of CRR Article 92b, and separately the need for consistency across the broader prudential framework. We outline these issues in more detail below, and recommend that the Bank of England work with the relevant UK authorities to remove Article 92b from UK legislation in its entirety.

Internal MREL

The Bank of England's approach to calibrating requirements for internal loss absorbency, i.e., internal MREL, is supported by AFME, as per our response to the Bank of England consultation on its SoP back in December 2017[2]. We believe that the Bank's policy is consistent with the agreements made at the international level on the topic, as reflected by Financial Stability Board's (FSB) Principles and Term Sheet on Total Loss-absorbing Capacity (TLAC).

One of the key features of the FSB TLAC Term Sheet with regard to internal TLAC is the application of a scalar within the range of 75-90% when calibrating the requirement.

The Bank 's Statement of Policy (SoP) clearly includes this under 7.7, i.e., "*The Bank expects that internal MREL for a material subsidiary will be scaled in the range of 75% to 90% of the full amount of external MREL that it would otherwise be required to maintain if the material subsidiary were itself a UK resolution entity…*".

[1] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

[2] AFME response to Bank of England consultation of October 2017 on internal MREL - https://www.afme.eu/Portals/0/globalassets/downloads/consultation-responses/AFME-PRD-response-to-BoE-on-Internal-MREL.pdf?ver=2019-09-11-144052-390

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The exact scalar within this range that applies should be the subject of consideration, based upon a number of factors, e.g., the resolution strategy that applies to the group, the credibility of the plan, any identified impediments to resolvability, and the outcome of discussions with other relevant authorities in crisis management groups. All of these are of course considered by the Bank in its SoP when determining whether to set internal MREL for a sub-group or subsidiary above the minimum 75% scalar. This is strongly supported and would help to ensure that internal MREL requirements are tailored to the bank in question, and provides a means to incentivise firms to improve upon these areas to attract a lower requirement (e.g., improving the credibility of their resolution plan and preparedness).

However, the Bank's SoP fails to adequately highlight that these decisions do not factor into the calibration of internal MREL requirements for material subsidiaries or sub-groups of certain banks.

This is due to the effect of on-shored legislation under Article 92b of the Capital Requirements Regulations (CRR2), as amended by Section 33 of the Capital Requirements (Amendment) (EU Exit) Regulations 2019[3], ('Article 92b').

Article 92b requires a fixed 90% scalar apply when calibrating the internal MREL requirements of material subsidiaries of non-UK Globally-Systemically Important Institutions (G-SIIs), where they are not resolution entities themselves. This overrides the Bank of England's own policy, which we strongly believe is appropriately proportionate and in our view the approach that faithfully implements the FSB's TLAC Term Sheet. It is therefore concerning to us that the Bank's policy in reality does not apply to all firms.

AFME fully appreciates that the Bank of England is not responsible for the applicable legislation, and that it does not have the power to amend the relevant legislation itself; this lies with the relevant ministry (HM Treasury) and ultimately with Parliament (as it is likely that primary legislation would be necessary to remove the Section in question). However, we strongly believe that this needs to be addressed through the removal of Article 92b such that the Bank's policy can apply in full. This should be taken forward to ensure requirements are calibrated proportionately, and that the Bank of England is empowered as the UK's Resolution Authority to make its own informed determinations of the requirements that should apply to the material subsidiaries of non-UK G-SIIs.

In light of this we encourage the Bank of England to first highlight more clearly the applicable and overriding legislation within its SoP. It would be somewhat misleading to suggest that the Bank's policy applied in all cases, and for the purpose of transparency, we would prefer to see references made to Article 92b for as long as it applies.

Secondly, we encourage the Bank of England to liaise with HM Treasury to seek the full removal of Article 92b. This would ensure the Bank's own approach can hold primacy on internal MREL. This is true not just for the calibration of internal MREL, but also on other important issues contained within Article 92b, i.e., on indirect issuance of internal MREL (for which again the Bank of England has its own policy).

Following the end of the transitional relief provided until March 2022, Article 92b will restrict the ability of firms to issue internal MREL eligible liabilities via entities not located in the UK or the home jurisdiction. This may prevent indirect issuance of internal MREL eligible liabilities to the resolution entity via the legal entity chain of ownership, and directly contradicts the MREL SoP, which permits both direct and indirect issuance of internal MREL eligible liabilities to the resolution entity. These geographic restrictions on issuance may disproportionately restrict a firm's ability to fund operations in the UK, and may require further large legal entity restructuring projects to comply with the rules, or direct issuance of internal MREL eligible liabilities to the resolution entity which could create tax or other legal, regulatory or operational issues. This follows restructurings that were implemented in 2018 ahead of Article 92b going-live as part of EU law.

[3] The Capital Requirements (Amendment) (EU Exit) Regulations 2019 – Section 33: https://www.legislation.gov.uk/uksi/2019/1232/regulation/33

Avoiding the conflicting and somewhat duplicative nature of Article 92b vis-à-vis the Bank of England's own policy in this area should be seen as an issue that is deserving of attention. The ongoing application of Article 92b, overriding the Bank's policy approach, imposes unnecessary burdens on those banking groups that have made the most progress on resolvability.

Internal MREL is an important element of the resolution framework. It is vital that a considered approach is in place to ensure the effectiveness of the regime while minimising the impact on firms (for example through having an approach with an appropriate degree of flexibility, especially in the tailoring of the requirements to each in-scope entity). The Bank of England's policy delivers on this, however it is not effective for many firms.

We note the MREL Review makes reference to the fact the Bank is continuing to work with overseas authorities to enhance cross-border resolvability, and will review its policy on intragroup MREL distribution in light of any progress in international engagement. We support all efforts by resolution authorities to enhance cross-border resolvability through greater collaboration and look forward to engaging further on this issue as progress is made.

Consistency across the broader prudential framework

Whilst we recognise that the Bank of England does not intend to make any changes to the current SoP with regards to MREL calibration, we believe that there is one element that should be considered, largely for consistency across the broader prudential framework.

Specifically, we note that in the Bank of England/PRA's UK Leverage Ratio framework consultation[4] (CP 14/21), the PRA notes that where the leverage ratio is a supervisory expectation for a firm (rather than a binding requirement), then there will be no leverage-based MREL requirement for that firm (i.e., there will be a risk-based MREL requirement). Whilst we support this view, we believe that in the event that the leverage ratio is deemed a supervisory expectation for the firm, then that firm should not have a leveraged-based internal MREL requirement, nor a leveraged-based external MREL requirement. A risk-based internal and external MREL requirement should instead apply.

A consistent approach that aligns the use of metric bases should be taken forward, i.e., RWA-based buffers on top of RWA-based MREL, and LR-based buffers on top of LR-based MREL. Mixing different buffer bases with the alternate base for external and internal MREL can lead to punitive and disproportionate requirements that are not consistent. We strongly encourage the Bank of England to maintain a consistent approach across the board.

If you have any questions regarding this response, or should you wish to discuss any points with us further, please do not hesitate to contact us.

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[4] Bank of England/PRA Consultations on changes to the UK leverage ratio framework - https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework