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

BSA response to Discussion Paper

March 2021

Building Societies Association

Introduction

The BSA warmly welcomes the Bank's decision to carry out a more holistic, wide-ranging review first, through this Discussion Paper, to be followed by a calibration CP. **The BSA has consistently supported the principle of appropriate MREL**, not least because our members, via the FSCS, paid a fair amount of the total resolution bill for the bank failures of the last financial crisis. At the same time, MREL issuance could prove a drag on present recovery. In our response (as well as addressing the specific questions in the DP and outlining the building societies' perspective) we therefore raise several wider issues. And we welcome others' contributions – now is the time for good ideas to be put on the table. These should all be considered as part of the complete picture so as to arrive at the optimum overall solution.

Executive summary

Building societies help to make competition in banking more effective: They provide competition, with a social conscience, for the big banks, in both mortgages and savings. This is demonstrated, for example, by better savings rates, and providing mortgages to certain market segments such as self-build or shared ownership that otherwise might have been underserved. The movement has grown successfully over the past 10 years, increasing its market share, and is well capitalised and remains innately conservative on risk, with tighter regulation, set in statute, to maintain its lower risk profile.

MREL policy can be better applied to achieve financial stability objectives: The combination of MREL and leverage regulations penalises this model without acknowledging its simplicity and relatively low risk. The cost of raising more capital or MREL resources will likely curtail lending and competition from large societies – or, worse, drive them up the risk curve. These perverse incentives to take on more risk and stifle healthy growth are the last thing that we need either in the current environment or in the longer term.

As simpler mortgages and savings businesses, **solvent run-off** could provide a better exit option for most large societies, without systemic impact. Nationwide aside, they have very limited transactional account activity, which is what otherwise can lead to hardship for customers in resolution. We can work with the Bank on the run-off concept.

Our refinements can enable building societies to contribute further to the Government's economic objectives: The framework of leverage ratio (LR) and MREL policy can be improved to better reflect these diverse business models in the deposit-taking sector. We propose using the thresholds to focus requirements on those banks that are either truly systemic and/or complex, or have a large current account base. Such a regime would be an important part of a regulatory landscape that will facilitate resilience, competitiveness and healthy growth, including in the regions across the UK where many of the affected societies are based. By setting the thresholds appropriately to target the critical risks to recovery and resolution of the largest and most complex firms, there need be little conflict between both the PRA's and FPC's primary and secondary objectives. All firms would continue to be accountable for their resolvability without exposing public funds to loss.

Building societies' perspective

Building societies have relatively low risk, simple and successful business models. They can help to support economic recovery, as they did very strongly after the last financial crisis. Their regional focus also supports the Government's levelling-up agenda, and they add to the vibrancy and diversity of competition in UK financial services.

Refinements to the Bank's MREL methodology are needed so as to mitigate the impending severe (and arguably anti-competitive) impact of the current policy on most of the five or six largest societies, while preserving both financial stability and lending capacity as we look forward to post COVID recovery and the long term future of UK financial services.

In simple terms, the current policy[1] means that societies or banks with balance sheets above the band £15-25 billion; or with numbers of transaction accounts above the band 40,000 -80,000; must hold full MREL comprising a recapitalization amount (RCA) as well as a loss absorption amount (LAA), with each calibrated (as presently required by BRRD[2]) as the greater of the risk- based and leverage ratio- based capital requirements (respectively, RBCR and LRCR). There are further adjustments, but the broad picture, which this position paper addresses, is:

MREL = max {2x RBCR, 2x LRCR}

The severity of this differential impact flows from the use of the non-risk based leverage ratio in the calibration of both LAA and RCA - so doubling the existing disadvantage that the LR itself creates for lower-risk business models such as residential mortgage lending. The BSA argued as follows in 2015, in response to an early EBA consultation on MREL design:

> *"The advantage of established CRR capital requirements is that they are risk-based, and therefore relate to the **real potential for losses**. For that reason, and for others, the leverage ratio should be excluded.*
>
> *……….*
>
> *..more importantly, the leverage ratio is explicitly, and deliberately, unrelated to any relative measure of risk or loss. So it is prima facie unsuitable to contribute to an assessment of loss absorption."*

So the BSA has consistently maintained that the LAA should not, logically, be leverage-based at all, even if the RCA remains so in order to reflect the LR as a Pillar 1 requirement.

The BSA's analysis focuses only on the societies that are likely to be classified in the mid-tier group referred to in the Discussion Paper. This shows that the four largest but non-systemic societies have healthy capital surpluses over current risk-based capital requirements and the Pillar 1 leverage ratio, and in general can comfortably meet MREL calibrated at 2x RBCR[3]. But it is the doubling up of the LR in the alternative calibration of MREL at 2 x LR that wipes out surpluses and creates capital shortfalls across almost all of these societies, as illustrated in the chart and table below. This averages out at a shortfall of 1.0% of leverage exposure, or almost £1.5bn –meaning

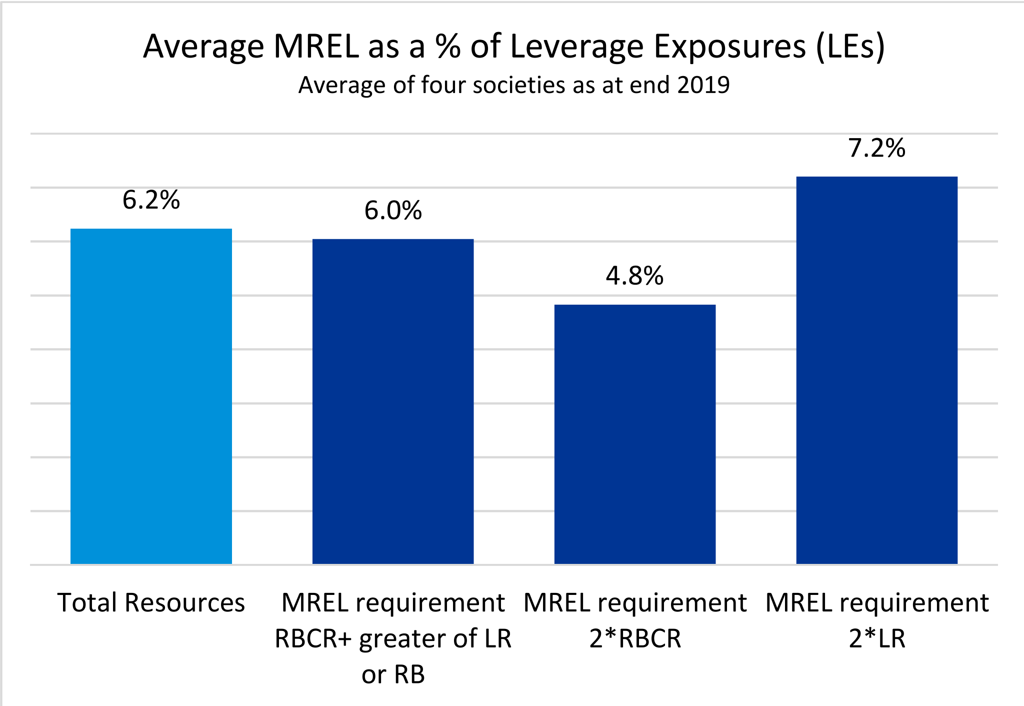
[1] The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) : Statement of Policy July 2018

[2] The EU's Bank Recovery and Resolution Directive

[3] Simple averages based on data at 2019 financial year ends for the four largest non-systemic building societies. Compares capital resources to capital requirements, including Capital Conservation Buffer, Countercyclical Capital Buffer at steady state of 2%pts, Systemic Risk Buffer (where relevant), but not the Pillar 2 buffer as this is not published. The surplus/deficit is expressed as a % of RWA or UK leverage exposure (LEs) as described, and simply averaged across the societies. The Total £ deficits are the aggregate deficits for those societies with shortfalls against requirements only, and are on a group basis with expectations of the Society shortfall being greater. The implied deleveraging is calculated based off these amounts, with an additional half a percentage point applied as management overlay.

reduced growth, deleveraging (potentially up to £27.8bn of lending, including the effect of a management buffer), or requiring extensive MREL issuance.

In contrast, a requirement based on a loss absorption amount of the risk based capital requirement plus a recapitalisation amount equal to the greater of either the risk based or the leverage based requirement results in a much smaller impact, with a shortfall of £0.3 billion and potential deleveraging of £10.5 billion.



	Notes	MREL requirement RBCR+ greater of LR or RBCR	2*RBCR	2*LR
Average surplus/shortfall (as % Leverage exposures)	1	0.2%	1.4%	-1.0%
Deficits against requirements, £bn	2	-0.3	-0.04	-1.5
Implied deleveraging, £bn	3	-10.5	-1.6	-27.8

Notes:

1. Simple average across the largest four non-systemic building societies, 31 Dec 2019 data
2. Total deficits across those societies with shortfalls against respective requirements
3. Based on those with deficits, the amount of deleveraging required to meet requirements plus a 0.5% management overlay

Problems with current policy

We should be clear, first of all, that all large societies can - at some cost - adapt to the current MREL policy: our case is not that their survival is threatened, but that the adaptation measures create undesirable side-effects and sub-optimal outcomes for those societies, their members, and the wider economy. Currently, large societies can readily issue MREL instruments, such as senior non-preferred debt, but these carry a significant and arguably unnecessary servicing cost, which risks skewing the issuer's business in various ways. And at some stages in the economic cycle, the cost of senior non –preferred debt may increase dramatically and/ or some societies may not have such ready access to issuance.

First, the obvious but perverse incentive for those societies' new business is to **go up the risk curve**, so generating the higher rate of return needed to service MREL issuance – how can this be desirable at the present time? Resolution policy could drive a wedge into the appropriate pricing for risk, such that lower risk borrowers could effectively subsidise higher risk borrowers.

Second, societies may alternatively decide to **"live within their means"**, and instead of issuing MREL instruments, curtail their asset growth - especially in the lowest risk, lowest return segment. This has two outcomes - reduced competition in those areas of the residential mortgage market, and a loss of aggregate lending capacity, just when this is needed to consolidate the post-COVID recovery.

Third, the policy doesn't properly recognise that in a very simple business model it is easier to **run-off** a larger institution: savings are, for the most part, covered by FSCS, whilst mortgages can run off or be sold without the need for bail-in.

Finally, we make the obvious point that where MREL resources prove excessive, their servicing cost is a pure waste - like **over- insuring against a particular risk**, way beyond realistic loss estimates. Moreover, firms may choose not to invest further in risk analysis as the benefits of more efficient risk assessments are curtailed by regulation.

The purpose of MREL

DP Q1 : Are there any issues or evidence that respondents would like to bring to the Bank's attention that would inform its review of the MREL framework, in particular relating to the thresholds for resolution strategies, the calibration of the requirements, the eligibility of instruments or the application of MREL within banking groups?

Section 1 rightly mentions the role of public funds, which were unfortunately necessary to cope with bank failures from 2007 onwards (of which the most substantial cases were the rescue by nationalisation of Northern Rock bank, and the resolution by partial transfer of Bradford & Bingley bank). But Box 1 seems - disappointingly - to imply that public funds carried the whole cost – which is quite untrue. This sentence is the most problematic:

HM Treasury also provided a further £29bn of loans to support depositors of failed banks, of which £15.7bn was used by the FSCS to compensate the depositors of Bradford & Bingley.

The further loans purely provided temporary liquidity to enable the various resolutions to proceed – as the FSCS had no standing fund. FSCS borrowed £20.4 billion in 2008 to meet the costs of compensating depositors in the 5 banks that had failed that year. It was always the case that these loans would be repaid in full with interest by the FSCS, with the money raised by annual levies on deposit-takers topping up any asset recoveries. The FSCS loans were repaid in full by May 2018: the interest on its loans and a capital shortfall on the non-B&B loan were met by levies on deposit-takers, which were also required to meet interest that accrued on a notional loan in respect of Dunfermline BS. The total cost to deposit takers amounted to £4.4bn, of which building societies paid out £1.1bn.

So, while it is of great importance not in future to risk public funds unnecessarily, to omit the relationship between this temporary liquidity from HM Treasury and the fact that the FSCS at the time had no standing fund, and to ignore the subsequent major contribution of FSCS levies to paying down the bills from 2007-09, risks misrepresenting what actually happened.

Moreover, the DP omits any mention of the subsequent DGSD requirement[4] for pre-funding deposit guarantee schemes, and the BRRD requirement[5] for establishing a resolution fund, and the permitted alternatives[6] that UK[7] adopted. Within the EU banking union by contrast, actual funds are already being built up, at member state level for deposit guarantee funds, and at banking union level in the Single Resolution Fund. Supported by the BSA, the UK took a different approach : the Treasury[8] earmarked for resolution the proceeds of the bank levy, but instead of putting it into a separate fund, the Treasury chose to spend the money as part of general revenue, against an obligation to provide the equivalent funds in future :

16.1 The BRRD requires Member States to establish resolution financing arrangements for the purpose of ensuring the effective application of the resolution tools and powers.

16.2 Where certain conditions are met, the Directive allows Member States to fulfil the requirement to establish resolution financing arrangements through mandatory contributions from the banking sector which are not held in a fund controlled by the resolution authority. This acknowledges and takes into account the fact that several Member States imposed bank levies before the BRRD was proposed by the Commission, to ensure fair burden-sharing and provide incentives for banks to reduce their funding and systemic risk.

16.3 The Government is of the view that the existing UK bank levy (Schedule 19 of the Finance Act 2011) meets these conditions and has previously set out its intention to use the levy to meet the ex ante funding requirements in the BRRD . This means that the BRRD resolution financing requirements can be met without imposing an additional upfront cost on UK institutions, ***and permits the Government flexibility in the use of those funds when they are not needed for resolution (as opposed to them being held in a separate fund controlled by the resolution authority.***

16.4 The Government would make these funds immediately available in the event of a resolution, if they were required, in accordance with Article 100(6). The Government would then need a mechanism for replenishing the ex ante funding requirement and, if necessary, raising extraordinary ex post contributions in accordance with Article 104 of the BRRD, in the event that the ex ante funding is insufficient.

Chapter 16 - Resolution financing arrangements (emphasis added).

This should also be understood, as it rather alters the DP's narrative about public funds. The UK's choice to spend the levies, and stick to "pay-as –you-go" for resolution if ever needed, is in itself a conscious acceptance of future risk to public funds. The BSA still maintains its original support for this approach, but the wider context should have been acknowledged in the DP. A further misconception seems behind the remark that *"MREL shifts risk from the public to the private sector"* – as we have demonstrated above, the private sector was already bearing substantial risk through the FSCS: the true difference that MREL makes is to shift risk from the **collective sphere** (both public *and* private sector) to the **individual bank** – *before it fails*.

Finally, regarding the level of application of MREL within banking groups, it surely goes without saying that MREL must be applied, at least, at the level of any **ring-fenced retail bank entity**: to do otherwise would make a mockery of the whole concept of ring-fencing.

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[4] EU Deposit Guarantee Schemes Directive as amended – see Article 10 et seqq.
[5] Consolidated text of BRRD and BRRD 2 – see Article 100 et seqq.
[6] See DGSD Article 10 (4) and BRRD Article 100 (6)
[7] Transposition of the Bank Recovery and Resolution Directive
[8] Ibid. Chapter 16, page 53 – see text box.

Potential impact on the public interest of a hypothetical mid-tier bank insolvency

DP Q2 : Does the discussion in Section 2 capture all relevant potential impacts of the entry into insolvency of a bank which meets the current indicative thresholds? If not, what other impacts should be considered?

The DP looks at the hypothetical case of a mid-tier bank going into insolvency rather than bail-in or partial transfer and asks very reasonable questions about public confidence and depositor protection. But it takes as given the current sub-optimal requirements for FSCS cover deriving from the amended DGSD, and then expresses concern about some of the resulting hard cases.

What the DP fails to do is ask, now that we can change the FSCS boundaries, whether this should happen first, and thereby refocus FSCS resource on the most deserving cases? For instance, amended DGSD extended FSCS cover to large corporates – that could easily be reversed. Once the FSCS lines are drawn in the right place, the Bank can be more robust in accepting that uncovered deposits are at risk.

The most interesting feature of the material on calibration in the DP is the explicit reference to the "deadweight loss" (page 13). It's a reasonable extension of the helpful reminder, also on page 17, that *"capital requirements are calibrated to absorb unexpected losses"* – in an individual case, if the calibration proved not quite right, and losses were higher due to large discounts on realisation in an insolvency fire sale. While this feature explains why the LAA may prove larger than 1 x RBCR, there is an opposite feature that similarly reduces the RCA: the ***natural shrinkage of the business and balance sheet of the bank through resolution***. There are several reasons why a resolved bank will end up somewhat smaller than the pre-resolution entity: during recovery actions, there are likely to be some disposals of assets or business lines – predecessors to the fire-sale realisations; liquid assets will be run down; and some maturing funding will probably not need to be renewed. Consequently, the resolved entity is likely to be substantially smaller (perhaps as much as 20-25%) than the pre-resolution balance sheet on which RCA is calibrated.

We also mention here the potential for solvent wind-down as an earlier alternative to formal resolution. The Bank /PRA rightly addressed this topic in a previous CP[9] dealing with non-systemic banks, and said the following regarding the ability for challenger banks to exit as well as enter the market in an orderly way:

"it is crucial they have the ability to exit the market in an orderly way, if required. This includes having a solvent wind down plan in place, to provide the potential option of winding down the business should other recovery options be exhausted."

In our published[10] response, we fully supported the normalisation and de-stigmatisation of solvent wind-down, and called for its wider application to non-systemic deposit-takers. We gave five reasons for this: optimum realisation values for assets; avoiding any appearance of crisis; conserving FSCS resources; no value-destruction from insolvency costs; and removing part of the threat of sanctions on directors of the bank. We do not rehearse these in detail, but we do suggest that solvent wind-down has an important contribution to make to the MREL debate. Coincidentally, we note in passing that Wyelands Bank is now engaged in what is effectively the completion of a solvent wind-down: the PRA stated[11] on 3 March that

"The firm has the resources it needs to repay all depositors in full and we have required it to operationalise an orderly repayment of its [remaining] *deposits."*

[9] CP 9/20 : Non-systemic UK banks : the PRA's approach to new and growing banks. [add link]
[10] BSA response to CP 9/20
[11] https://www.bankofengland.co.uk/news/2021/march/statement-on-wyelands-bank

Banks' experience of issuing MREL instruments

DP Q3 : *Does the discussion in Section 3 accurately reflect the experience of banks in issuing MREL instruments? If not, please set out your perspective on banks' issuance.*

The BSA is not aware that societies have had specific problems in issuing MREL instruments. Some struggling mid-tier banks may have done so: one bank for instance had to pull an MREL issue in September 2019, having failed to get it away at 7.5% - the coupon then had to be raised to 9.5%. Another bank issued MREL-related bonds at 9.0 %.

One important building society specific point that will need to be addressed through legislative change (by the Treasury, independently of final MREL calibration) is that any MREL instruments, typically issued to wholesale investors, should be **excluded from the calculation of the funding nature limit**[12] in section 7 of the Building Societies Act in the same way (and for essentially the same reasons) as regulatory capital instruments ("own funds") are already excluded – see Section 7 (3) (a).

Regulatory and market developments

DP Q4. *Does the discussion in Section 4 capture all of the regulatory developments relevant to MREL? If not, which other regulatory developments are relevant to the Bank's review of MREL policy.*

As we discuss elsewhere in this response, policy relating to the Leverage Ratio is clearly relevant. In addition, proposals for risk weight floors on mortgages are relevant to how leverage requirements and therefore MREL are set.

DP Q5. What are your views on the Bank's current graduated approach to 'growing into MREL' and in particular, the provision of a transition period of at least three years? The experience of some mid-tier banks in issuing MREL instruments suggests that this period may be insufficient for them to establish themselves as issuers of those instruments. The Bank would particularly welcome public comments on this point.

We discuss a potential approach to graduating MREL in our proposals below on thresholds.

DP Q6. Should the Bank update its definition of transactional accounts for the purposes of its indicative resolution thresholds, and if so how? The Bank would welcome feedback on whether and how it should be adjusted to take account of changes in market structure and customer behaviour.

The suggestion that transaction accounts be differentiated between primary and secondary, with the primary account being the one which receives the main income, from which standing orders and direct debits are paid, etc, deserves consideration, with the caveat that it may prove difficult to ascertain whether a customer account is primary or secondary.

An alternative simplifying move would be to start by aligning the basic transaction account definition with the existing definition of a payment account (which societies have to use already for PSR purposes) with the definition then narrowed further at aggregate level, for example based on frequency. We think it is also worth noting the point that the most damaging recent incident involving consumers being unable to access their cash was in fact Wirecard, which is not even a bank, but turned out to be a debacle not only in the UK, but even more in its home state Germany, where senior regulators' heads have now rolled[13]. We are aware that the Treasury is now applying a special administration regime for such payment firms – should they perhaps also be made to hold MREL?

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[12] https://www.legislation.gov.uk/ukpga/1986/53/section/7
[13] "Wirecard lessons for watchdogs"

BSA proposals for refining MREL

(i) Thresholds

As MREL is calculated on the basis of other requirements, both the thresholds for MREL itself and the thresholds for the base requirements are relevant. In particular, MREL compounds the discrimination in the leverage regime against relatively low risk businesses. In the context of other reforms – new IRB capital floors, as well as new risk weight floors for individual mortgages and mortgage portfolios (as per CP 14/20) – the leverage ratio will not be the only or primary guard against model risk, and it can therefore properly become the backstop as originally envisaged, rather than binding tightly on lower risk businesses, either directly or via MREL.

The BSA continues to advocate raising the balance sheet thresholds for MREL above the present indicative range of £15-25 bn. In response to the first Bank CP we argued for £50bn (in line with the existing threshold for initial application of the leverage framework, and other measures such as concurrent stress tests) and anyway the UK's threshold appears to be on the low side by EU standards. BRRD requires MREL for all institutions above € 100 billion but leaves it optional for those below that threshold. We therefore propose that full leverage and MREL should apply only for **much larger firms** than is currently the case.

Recent experience also confirms that it is **interruption to transaction accounts** that poses the greatest threat to confidence and thus to financial stability, because millions of people now rely on access to payment facilities direct from bank accounts, whereas immediate access to (FSCS-protected) savings - as opposed to transaction balances - is less of a concern. The experience of lockdown greatly reinforced this – access to savings was in practice greatly reduced as branches reduced opening hours, and restricted footfall, but this did not cause any apparent problems. By far the biggest problem occurred when Wirecard failed, and its payment platforms could not operate – leaving ordinary consumers stranded without any means to effect payment for essentials. The BSA considers this strengthens the case for full MREL to be required only where a deposit-taker meets ***both*** thresholds – one on balance sheet size ***and*** one on the number of transaction accounts.

In considering the options for recovery or resolution of a large, but non-systemic, society were it to get into difficulties, one other factor should be considered - the possibility of **solvent wind-down**. We have argued separately (in our response to PRA CP 9/20) that solvent wind-down should be normalised and de-stigmatised as a suitable exit route for all non-systemic deposit-takers, banks and building societies, not only for new or fast growing banks. If that were done, then the Bank could be reassured that for a large society that is **not** domestically systemic and does **not** have extensive transaction accounts, full MREL designed to support whole-firm recapitalisation with bail-in is not necessary.

So, in conclusion, **we propose that full leverage and MREL should apply (only) to all institutions above £100[14] billion, and for MREL to those above £50 billion which also have more than say 100,000 transaction accounts.**

There is also the quite separate problem, at any hard threshold, of the cliff-edge: we are aware that the Bank sought to mitigate this in the current policy by setting a range rather than a single hard threshold on both size and transaction account numbers. Some form of phasing –in will be desirable to prevent the final thresholds from operating as a barrier to growth and therefore to competition.

Nevertheless, we appreciate that current resolution policy is binary – there is no conceptual half way house – so, once a firm is at the cliff, it needs to get over it. The challenge is what is the best way to scale that cliff, as it is a big step up. On a 3 or 5 year timetable, firms don't want to be forced issuers of capital, as they would pay through the nose. 5 years is too tight for what almost amounts to a doubling of capital requirements, as to get there would need a huge amount of additional capital, especially under 2x LR.

So the Bank could set a far-off threshold, and if built with partial requirements kicking in earlier, a firm would still remain on the modified insolvency approach until it actually gets to the top of the cliff. It doesn't have to raise the MREL in one go, and firms don't have to stop growing, cancel acquisitions, etc. A firm can make incremental

[14] This is slightly more than € 100 bn but a round figure for simplicity !

decisions more easily if it knew where the slope was going. At present, it is not as transparent: all firms wait as late as possible as they don't want the carrying cost of currently superfluous MREL. If clearer, staged requirements are introduced, firms will have to accept some interim carrying cost.

A stylised example of this approach, based on the thresholds we suggest above for balance sheet size and number of accounts, indicates how this could be structured to give a clearer transition to a full MREL regime by combining the thresholds for size and complexity in a proportionate way.

Graduating the proposed thresholds

Size, £bn	% of MREL Recapitalisation amount required				
100 or greater	100%	100%	100%	100%	100%
87.5to under 100	75%	100%	100%	100%	100%
75 to under 87.5	50%	75%	100%	100%	100%
62.5 to under 75	25%	50%	75%	100%	100%
50 to under 62.5	0%	25%	50%	75%	100%
Number of transactional accounts	>60k, <=70k	>70k, <=80k	>80k, <=90k	>90k, <=100k	>100k

(ii) Calibration

The BSA's original argument in favour of setting the loss absorption amount at the risk based capital requirement in all circumstances, with the recapitalization amount at the greater of the risk based and leverage based capital requirement, had logic that we think was clear and compelling. A risk based capital requirement is calibrated already to absorb gone-concern losses at a defined level of severity (1 in 200 stress?), while the LR was never intended to be used so precisely. Unfortunately this approach was precluded by the text of BRRD[15] so long as that remained binding. And that in turn is predicated on the LR becoming a binding Pillar 1 requirement for all deposit-takers (not only "Basel banks") as specified in CRR 2.

But the roll-out of the leverage ratio to all CRD deposit-takers in the UK is no longer automatic under CRR 2 – the UK having on-shored by law only the previous CRR text plus items from CRR 2 that come into effect before the end of 2020, whereas the introduction of the hard LR comes in only in June 2021. The UK therefore would therefore need to adopt this as an independent policy choice, and make the supporting case including full CBA, which in turn would have to identify and cost consequential impacts of the LR such as the MREL effect on large societies. If, as a result, the PRA decided not to roll out the LR to other banks and building societies, the MREL formula should adapt automatically – since loss absorption and recapitalization amounts for these non-systemic firms would both equate to their risk based capital requirement only.

A more limited mitigation would be for the Bank / PRA to remove (in line with CRR) or vary the 35% coefficient by which the CCyB, an existing risk-based buffer, is translated into its leverage equivalent, the CCLB. While this coefficient may be appropriate for universal banks with a full spread of asset classes, Bank / PRA could adjust it, for instance to 20% for specialist mortgage lenders such as building societies, which are more likely to be bound by the leverage ratio.

An alternative potential approach to the changes we have suggested above builds on a holistic overview of existing risk management activity carried out by MREL-scope societies (rather than a silo mentality) as follows. Significant resources are already consumed by IRB, developing complex models, with high levels of mandatory requirements in order to arrive at a thorough risk based assessment of the capital the society would require in a stressed economic environment. Significant resources will also be consumed in ensuring that the society fully understands how it would respond in a recovery situation, including the actions to achieve recovery, and also

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[15] Article 45c

what would be involved in a resolution scenario. None of this information however appears to be utilised in order to arrive at the capital/MREL resources required in a resolution environment, particularly where the firm finds itself under leverage-based MREL constraint. No account is taken of the riskiness of the business, actions that would be taken during recovery to reduce exposure, or the ease with which resources could be generated through disposals.

By better aligning RAF[16]/MREL/IRB, one could have an approach where a few extra steps are taken within the RAF (societies are not required to do this within the existing mandate) to evaluate a more accurate view of capital resources required under resolution (at present they simply need to demonstrate they have the tools in place to do this). This would add more weight to the RAF, and provide an incentive to do it thoroughly as it affects the MREL/capital requirement. This could then be evaluated by the Bank /PRA in much the same way as the existing PRA buffer is evaluated, to arrive at a more bespoke and more accurate assessment of requirements under resolution. If this was deemed too bespoke and too complicated, a grading process could be established whereby different percentages were applied based on the quality of the RAF, and the complexity, size, and risk of the business. This preferably wouldn't incorporate leverage, but if it was viewed that leverage needed to be incorporated, a more robust approach to leverage could be to have a different weighting applied to high level product categories, whereby lower risk products are given a lower leverage weighting – as mentioned above.

Conclusion

We welcome the open and transparent approach in this DP, and we appreciate the Bank's readiness to engage with the BSA and affected societies. We put forward the foregoing views and suggestions as a contribution to this important debate, and stand ready to assist the Resolution Division further as we move to the next stage with the CP.

March 2021

[16] The Bank's Resolvability Assessment Framework

Jeremy Palmer / Andrew Gall

jeremy.palmer@bsa.org.uk; andrew.gall@bsa.org.uk

York House
23 Kingsway
London WC2B 6UJ

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk

www.bsa.org.uk

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 over £435 billion, and account for 23% of the UK mortgage market and 17% of the UK savings market.