Bank of England

The Rt Hon. the Lord Forsyth of Drumlean
Chair, Financial Services Regulation
Committee
House of Lords
London
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Dave Ramsden
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22 January 2025

Dear Lord Forsyth

Financial Services Regulation Committee Inquiry into the FCA and PRA's Secondary Competitiveness and Growth Objective – MREL indicative total assets threshold

I am writing to you and the Committee further to Sam Woods's evidence given on 8 January 2025. In response to a question from Baroness Bowles, Sam suggested the Bank would explain further the rationale for the current calibration of the indicative total assets threshold for setting a bail-in preferred resolution strategy and consequently requiring a firm to meet a minimum requirement for own funds and eligible liabilities (MREL). MREL is a requirement for firms to maintain a minimum level of equity and eligible debt, typically above minimum capital requirements (MCR), so they can be 'bailed in' or otherwise support a resolution should a firm fail. The purpose of MREL is to help ensure that, when firms fail, the resolution authority can use these financial resources to absorb losses and recapitalise the continuing business and support its restructuring. I also want to outline our current thinking on the proposals for the revision of the total assets threshold.

Why is a bail-in indicative total assets threshold set?

To understand why the indicative threshold is set where it is, it is important to contextualise how MREL resources would be deployed in the event of a bank failure. The

Bank is statutorily required each year to set a preferred resolution strategy for every UK bank and building society, although the strategy that is adopted in the event of an actual failure will depend on the strategy which best services the public interest in light of the circumstances of the failure.

There are three broad resolution strategies:

(i) recapitalisation via a bail-in of the firm's eligible liabilities, followed by extensive restructuring of the failed business ("bail-in");

(ii) a transfer of all or part of the business, either directly through a sale to a willing private sector purchaser or via Bank of England-owned "bridge bank" to allow more time for such a sale to be negotiated and completed ("transfer"); or

(iii) entry into a modified insolvency process, involving an immediate cessation of business and disruption for bank customers, a rapid payout of insured deposits by the FSCS funded by industry levies, and potential losses for other claimants (including uninsured deposits above the FSCS's limit of £85,000) on the insolvent bank's estate.

MREL is required for firms with a preferred bail-in or transfer strategy to ensure that there is sufficient loss absorbing and recapitalisation capacity for an orderly resolution which minimises risks to financial stability, disruption to critical economic functions, and risks to public funds. The indicative total assets threshold[1] for bail-in strategies is currently set at £15bn-£25bn. It was initially set in 2016. This indicative threshold, as well as a separate indicative threshold for setting a transfer preferred strategy (based on the level of a firm's transactional accounts), is set in consultation with HM Treasury. Firms subject to a preferred bail-in resolution strategy are generally required to meet a quantum of MREL equivalent to two times their minimum capital requirement[2].

Beyond the starting assumption of MREL being set at two times minimum capital, the calibration of the threshold was a risk-based judgment guided by the Bank's view that for a firm of a size greater than £15bn - £25bn:

[1] Total assets is one of the two existing thresholds for setting a stabilisation power preferred resolution strategy. The others is the level of transactional accounts which is not covered further in this letter. Further detail on both is set out in the Bank's latest consultation paper [**Amendments to the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) | Bank of England**].

[2] This quantum is designed to be adequate to absorb losses at the point of failure and to have enough resources to recapitalise the firm for it to continue to operate as a going concern post resolution.

a) insolvency would be unlikely to serve the public interest, taking into account the negative impact on the UK financial system as a whole that the failure of such a firm might have; and

b) it is insufficiently likely that a suitable buyer for such a firm could be found, taking into account the complexity of such a transaction. The larger a given firm is, the less likely it is that there will be a willing, suitable purchaser. This leaves bail-in as the only option which would avoid the difficult choice between some form of public ownership and therefore risk to public funds, or entering into a disruptive insolvency that would not serve the public interest.

Setting the threshold as an indicative range, rather than a specific defined point, allows the Bank to exercise a degree of judgment around when to change a growing bank's preferred strategy to bail-in.

Reviewing MREL requirements

In 2021 we undertook a further review of MREL. In response to feedback that some smaller firms faced difficulties accessing the funding market, we introduced new arrangements to provide a gradual transition to meet MREL. These included a six-year glidepath (with the possibility of a further two-year extension if needed) and a notice period of up to three years before entering the six-year glide path. These changes, which aim to reduce "cliff-edge" effects, were welcomed by many banking industry stakeholders. We concluded at the time that, with these changes, our MREL policy continued to provide an appropriate degree of protection for public funds while ensuring a proportionate approach for growing firms. HM Treasury concurred with this view. Further, regarding the challenges smaller firms can face, because of their size, to issue and refinance marketable debt securities that can count as eligible liabilities for MREL in the way that larger banks can (which I have previously recognised[3]), I do want to reemphasise a point Sam made in his evidence to the Committee that the cost to smaller banks will vary firm by firm in accordance with the market's view of the relative risks of the debt - a factor the Bank does not control.

We have kept developments under review since the 2021 review. The level of the indicative thresholds continue to represent a finely balanced judgement, based on our experience of contingency planning about the thresholds at which firms would likely not meet the public interest test and could therefore be allowed to enter insolvency if they failed. Our experience of contingency planning and the use of resolution powers in practice, which will evolve over time, continues to inform our judgement. For example,

[3] The weekend starts here − speech by Dave Ramsden | Bank of England

the failure of Silicon Valley Bank UK (SVB UK)[4] in March 2023 demonstrates that a small bank, for which our preferred resolution strategy had been insolvency, can at the time meet the public interest test and therefore necessitate the use of stabilisation powers.

Amendments to the Bank's approach to MREL – 2024 consultation

In our recent consultation[5], we proposed to increase the indicative total assets thresholds range to £20bn-30bn to reflect nominal economic growth since the MREL regime was last reviewed. This indexation proposal seeks to keep the framework future-proofed, and the threshold consistent and stable over time without fundamentally shifting the delicate balance on who pays for the failure of a smaller firm. I want to be clear that the proposals relating to the indicative thresholds do not reflect a change to the risk appetite for the protection of public funds in resolution.

The new mechanism for bank recapitalisation in the Bank Resolution (Recapitalisation) Bill currently before Parliament could be used to support a resolution in connection with a transfer stabilisation power. With that in mind, we also proposed to remove MREL for firms with a preferred transfer strategy. If enacted, the new mechanism will provide for the capital (from industry levies) that may be necessary for a successful transfer resolution of a smaller firm without risk to public funds, in the absence of an MREL requirement. Our most recent proposals remain under consultation and are subject to secondary legislation being brought forward by HM Treasury. We will carefully review and consider all feedback we receive before finalising the policy, giving full consideration to the need for proportionality in securing financial stability and our other statutory objectives.

Yours sincerely

Dave Ramsden
Deputy Governor, Markets and Banking

[4] SVB UK had a total balance sheet size of around £10bn before it suffered an accelerated withdrawal of a large amount of deposits and failed in March 2023 as a result of the failure of its US parent bank.

[5] **Amendments to the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) | Bank of England**