

EBA Interim Report on MREL

BSA comments and response

25 August 2016

Introduction

The Building Societies Association (BSA) welcomes the EBA's consultation on this Interim Report on MREL and commends the thoroughness of the analysis contained in the report.

The BSA represents all 44 UK building societies. Building societies have total assets of over £345 billion and, together with their subsidiaries, hold residential mortgages of over £270 billion, 21% of the total outstanding in the UK. They hold over £250 billion of retail deposits, accounting for 18% of all such deposits in the UK. They employ approximately 40,000 full and part-time staff and operate through approximately 1,550 branches.

The BSA is a member of the European Association of Co-operative Banks, and supports the more detailed and comprehensive response that the EACB will be submitting. In this note, we highlight a few key issues of particular relevance to our members.

Building society context

A key consideration for our members as regards MREL is the non-availability of “structural” subordination. Under UK law a building society cannot establish a holding company through which structurally subordinated senior unsecured instruments could be issued. Rather, the society, which is directly owned by and accountable to its individual customer-members, can only be the top entity in any group structure. This feature may well be encountered in other situations across Europe where credit institutions may be mutual, savings or cooperative entities rather than proprietary joint-stock companies.

To raise sufficient MREL, therefore, where explicit subordination is to be required, it will be necessary for a society to issue instruments that are either contractually subordinated on an individual ad hoc basis, or benefit from a statutory regime that specifies their subordinated ranking. Such issues could take the form of Tier 2 regulatory capital, or – potentially – a new “Tier 3” instrument.

Reference base (denominator)

We support the move to RWAs as the denominator. We are not persuaded that the Leverage Ratio is needed as a back stop in order to deal with alleged RWA variability – otherwise this pre-empts both any final EU decision as to whether the leverage ratio should in fact be introduced as a Pillar 1 measure; and the final changes to current methodologies designed to reduce the variability of RWAs, especially on the IRB approaches, currently being considered in Basel. If the leverage ratio is to be used at all, it must be modified to remove at least the most egregious of its acknowledged defects by removing central bank deposits from the exposure measure.

Stacking of MREL

We accept the logic of removing “double counting” and therefore of “stacking” MREL on top of minimum capital requirements but below capital buffers – but noting at the same time that a range of other non-capital instruments can be used to meet MREs, so the “stack” is rather more complicated. We strongly support an important comment from the EACB – that another form of double counting should also be avoided, by ensuring that neither the MREL loss absorption and recapitalisation amounts include any element of buffer.

Breach of MREL

We think it is important to avoid any suggestion of automaticity – indeed, the example of the PRA’s proposed approach underlines this – PRA stating *“it is important to note that a breach of MREL does not automatically mean that the PRA will consider the firm is failing, or likely to fail, to satisfy the Threshold Conditions.”* And we commend the EACB’s arguments on this point.

Redemption of MREL instruments

Early redemption of MREL instruments should not require prior regulatory approval, so as to facilitate efficient liability management.

Eligibility criteria: subordination

We explained above why the structural route is simply not available to UK building societies as a matter of law (even though it appears, as suggested by EBA, to be the UK authorities’ favoured solution for large ring-fenced banks). We agree with EBA that there are identifiable benefits to subordination, but as EBA also recognises¹, subordination is not necessary for all firms or resolution strategies – giving the example of partial transfers of preferred and covered deposits. Moreover, regardless of the logic that, provided the choice of legal method does not affect the PD/ LGD, it should not affect the pricing, there is a risk of fragmentation caused by complexity and uncertainty if in effect subordination is left wholly to individual contractual terms. We also agree with EBA that relevant information should be available to investors regarding banks’ creditor hierarchy

We can see that where subordination is required, a statutory approach should preferably be available in all member states, with the advantages of consistency, transparency, and – we expect – enhanced investor understanding. Generic (rather than merely instrument-specific) information on banks’ creditor hierarchy could then be provided. This statutory approach, similar perhaps to what has already been commenced in France, would complement the structural route which, as explained, is not necessarily available to institutions outside the joint-stock company tradition.

One feature of the tightening of eligibility criteria for regulatory capital under CRR implementing Basel 3 is that, subject to the relevant transitional period, institutions may well have non-compliant legacy capital instruments that they are unable easily to redeem but which will nevertheless be perfectly suitable as MREL. EBA should do everything possible to facilitate the efficient recycling of residual non-compliant capital for MREL purposes.

We also draw to EBA’s attention a small but important technical point. Since some of our members may rely on Tier 2 regulatory capital instruments for MREL, we consider that these should receive full recognition as MREL until maturity. This recognises the distinctive purpose of MREL compared with all CRR regulatory capital.

¹See Page 56 of the Interim Report

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The Building Societies Association (BSA) is the voice of the UK's building societies.

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 £330 billion, and account for approximately 20% of both the UK mortgage and savings markets