The Rt. Hon Karen Bradley MP
Chair, APPG on Challenger Banks and Building Societies
House of Commons
London
SW1A 0AA

20 April 2021

Dear Chair,

Reforming the UK's Resolution Regime for Mid-Tier Banks

We are writing to you as representatives of the UK mid-tier and specialist banking sector to outline how we could better support the Government's efforts to rebuild the economy post-pandemic, and how this can be accelerated by adjusting the UK's resolution regime, which we feel currently acts as a barrier to growth and impedes the ability of mid-tier and specialist banks to compete with large UK banks. We would be very keen to discuss these matters in further detail with you and your colleagues on the Challenger Banks and Building Societies APPG.

A strong mid-tier and specialist banking sector is an integral part of the future growth and prosperity of the UK economy. This is especially true as we seek to establish the UK's business and economic regime outside of the EU and look to rebuild our economy following the Covid-19 pandemic. We are proud of the role that we have played in supporting customers and small businesses over the course of the pandemic. As we emerge from this public health crisis, it is because of our smaller scale, our deeper roots within the communities we serve, and the more personal and innovative services we provide, that we believe we can play an integral role in the national effort to rebuild the economy.

You may be aware that the Bank of England has recently published a Discussion Paper on the review of its approach to setting a minimum requirement for own funds and eligible liabilities (MREL) – a critical element of the Bank of England's resolution regime, and to which we have formally responded. Although we recognise this is primarily a matter for the Bank of England, we are seeking support from HM Treasury and parliamentarians, in order to seek improvements to the regime, delivering better outcomes for customers and removing barriers to growth and competition. Doing so would have substantial benefits to people and businesses right across the country, allowing for a faster and fairer economic recovery.

We would like to draw your attention to three benefits of MREL reform, in particular:

1. Unlocking capital for future lending

Businesses and households will continue to need access to lending to help them recover and grow over the coming years. This will include transitioning away from the different financial support packages made available by HM Treasury to banks to support customers. Based on an initial, high-level assessment we estimate that MREL reform could unlock between £24bn to £28bn in additional lending capacity over the next five years[1] to meet this demand. As you will be aware, mid-tier banks have relied more on retained earnings to meet their MREL requirements than the capital markets. The reasons for this are many but are primarily driven by structural imbalances in the sterling debt capital markets that put mid-tier and specialist banks at a significant disadvantage and increase costs compared to the large UK banks. Reforming the MREL regime would allow us to choose to put that capital – which is otherwise withheld or paid out to debt investors – towards further lending. Thanks to our geographical spread, and

[1] This is based on debt interest savings from current and potential MREL debt issuance by mid-tier banks and building societies over the next 5 years being used to support a mix of retail and SME lending.

our comprehensive knowledge of our customers, as a group we are well placed to ensure this lending helps to fuel the Government's priority industries and regions.

2. Enhancing competition to drive growth and speed up recovery

The current MREL threshold discourages growth, with mid-tier and specialist banks being forced to remain below a certain size to avoid being caught by the regime. It leaves a notable absence of mid-tier competitors of scale that can support SMEs, drive regional growth and investment and level-up the country.

Mid-tier and specialist banks like us can tailor our products to customers in ways that the large banks cannot and focus on areas of the market underserved by larger operators. Yet without size and scale, our ability to meaningfully dent the stranglehold of the large banks is limited, which in turn limits our ability to innovate.

We can help SMEs and households to rebuild from the pandemic in a way that suits their needs, but we would be better equipped to do so if we were able to compete with the larger players. As evidenced by the Competition and Markets Authority, it is mid-tier providers like us that consistently provide better service compared with the larger institutions. There is no doubt that the UK is already a good place to start a bank, as evidenced by the number of new licences issued in recent years, however we feel strongly that the changes we are calling for would allow banks to scale more effectively, particularly against a background of stronger international competition.

3. Encourage investment by renewing our position as the world's financial hub

The Chancellor has said recently that the UK's financial services sector is starting a new chapter. It is vital therefore that as we move forward, we seize every possible opportunity to ensure we protect our position as the world's pre-eminent financial centre, keeping our economy on a strong footing. However, we note that the US and EU have set MREL threshold levels at much higher levels than the UK. As is the case in the US, this is partly driven by having a fully funded depositor insurance fund.

This places the UK at a competitive disadvantage when investors are weighing up the best jurisdiction to start a new bank or invest in an existing firm. The measures we are proposing to the Bank of England would remove this handicap. We need to ensure that the UK remains one of the best places in the world to invest and start a new business, which in turn boosts competition and aids the economic recovery.

MREL is a critical element of an effective resolution regime. Requiring systemically important banks to hold additional debt capital to ensure the stability of the industry, and protection of taxpayers, is the right thing to do – this is why we greatly welcome the Bank of England's review. However, the regime needs to be appropriate and proportionate without impacting the ability of mid-tier and specialist banks to support the recovery, compete with large UK banks and deliver better customer outcomes. We are confident that safety in the banking sector can be maintained against a background of reform, on account of the significant diversity of size and model of banks across the sector, as well as the already significant strengthening of the regulatory regime over recent years.

In addition, to allow the UK to seize the opportunities ahead, these regulatory change proposals need a step change in their implementation. We need both Government and regulators to take a more proactive approach to turbo charge change and set out ambitious market reform goals.

We attach for your reference a letter we have recently sent to the Bank of England which sets out in further detail our key recommendations for MREL reform and why these are a matter of increasing urgency. Representatives of our group would greatly welcome the opportunity to meet with you to discuss these matters, or to present to the APPG on this matter if that would be of interest to you and the group. If we may, we will ask our colleague benjamin.robinson@interelgroup.com to follow-up with your office to see if a meeting can be arranged

We would be grateful if the issues raised in this and our accompanying letter could be considered as part your group's inquiry into post-Brexit regulatory reform, and therefore we copy this letter to the group's secretariat for their information. We also understand that some of your parliamentary colleagues in the APPG for Fair Business Banking, in particular that group's Chair, Kevin Hollinrake, may have an interest in this area, and therefore we would be happy to attend a meeting or sessions of your groups jointly if that is something that would be feasible or of interest to both groups.

Yours sincerely,

Aldermore	The co-operative bank for people with purpose	Metro Bank
Phillip Monks OBE	Nick Slape	Daniel Frumkin
monzo	OakNorth Bank	osb Group
TS Anil	Nick Lee	Andy Golding
paragon	Shawbrook Bank	Starling Bank
Nigel Terrington	Ian Cowie	Anne Boden
TESCO Bank	TSB	
Gerry Mallon	Debbie Crosbie	

Appendix 1 - MREL Summary

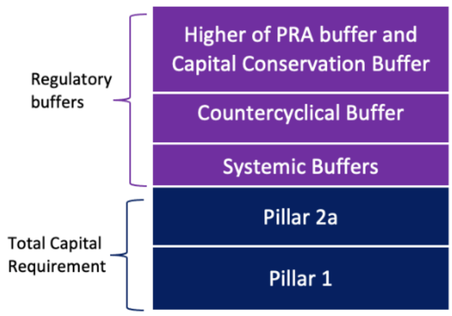
What is MREL

1. Minimum requirement for own funds and eligible liabilities (MREL) is a key element of the Bank of England's Resolution regime.
2. Its purpose is to help ensure that, should a large, systemic firm fail, it has sufficient capital to absorb losses and recapitalise the business, so that it can continue to provide critical functions without relying on public funds. The impact of systemic firms failing quickly and winding up could pose a significant risk to financial stability as they provide critical services to the economy, such as deposit taking and lending, which cannot be quickly absorbed by other firms. Therefore, in the event of a failure, systemic firms need to be able to absorb losses and recapitalise to remain a going concern. This stabilisation allows systemic firms to continue to provide critical functions, restructure or be wound down in an orderly manner.
3. MREL also supports financial stability by helping to remove any funding distortions caused by expectations that governments would bail out large, systemic banks should they fail.

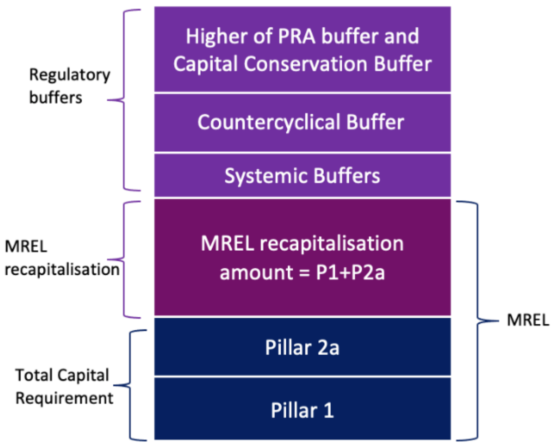
How is MREL currently calibrated?

4. MREL is calibrated as total capital requirements plus a recapitalisation amount.
5. For firms with over 40,000 transaction accounts or a balance sheet of £15bn-£25bn the recapitalisation amount is set at 100% of the total capital requirement. Regulatory buffers need to be held on top of the recapitalisation amount. Therefore, MREL essentially doubles the amount of minimum capital banks need to hold, on top of which they hold their regulatory buffers. This applies to all banks in the regime regardless of size or systemic importance, for example this applies to the OSB Group and Coop Bank in the same way it applies to HSBC and Barclays.
6. The Bank of England has published interim and end-state MREL requirements for firms in scope.[2]
7. The range of MREL requirements range from 16% - 48% of risk weighted assets (RWAs).

Regulatory capital stack[3]



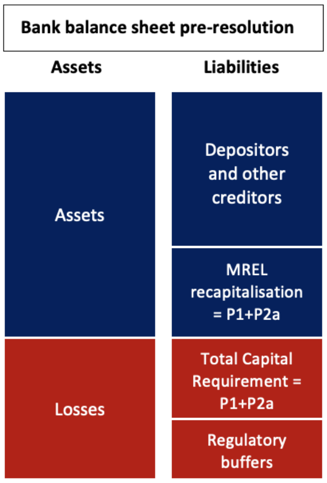
MREL capital stack for systemic firms



[2] https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/resolution/interim-and-end-state-mrel-2021.pdf?la=en&hash=7D7BC3D90ED5EA6F3DB0CD5C2D58BAB8798594A9

[3] Diagrams are stylised and not to scale. Systemic buffers apply to firms with more than £25bn of deposits.

How does MREL work in the case of a bank failure?



- A bank makes losses absorbed by its buffers and total capital requirement (TCR). Since losses have eroded its TCR the bank is placed in resolution.
- MREL recapitalisation debt is bailed-in and converted to equity.
- Minimum capital requirements in the resolved firm are met without losses imposed on other creditors, depositors or taxpayers.
- A smaller, less risky bank continues to operate.