HM Treasury

Transposition of the Bank Recovery and Resolution Directive II:

consultation

June 2020

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Chapter 1
Introduction

1.1 The Bank Recovery and Resolution Directive II (BRRDII) was published in the Official Journal of the European Union (OJEU) on 7 June 2019 and entered into force on 27 June 2019. The Directive makes amendments to the original 2014 Bank Recovery and Resolution Directive (BRRD) provisions, in order to update the EU's resolution policy and Minimum Requirements for Own Funds and Eligible Liabilities (MREL) framework.

1.2 The UK played a pivotal role in the design of EU financial services regulation. The Government remains committed to maintaining prudential soundness and other important regulatory outcomes such as consumer protection and proportionality. However, rules designed for 28 countries cannot be expected in every respect to be the right approach for a large and complex international financial sector such as the UK. Now that the UK has left the EU, the EU is naturally already making decisions on amending its current rules without regard for the UK's interests. We will therefore also tailor our approach to implementation to ensure that it better suits the UK market outside the EU.

1.3 During the Transition Period, and under the terms of the Withdrawal Agreement, the Government will implement EU legislation that requires transposition before the end of 2020. This includes the transposition of BRRDII by 28 December 2020.

1.4 In our transposition of BRRDII we are not intending to transpose the requirements in the Directive that do not need to be complied with by firms until after the end of the EU Exit Transition Period, in particular Article 1(17) which revises the framework for MREL requirements across the EU.

1.5 MREL is the minimum amount of equity and debt that a firm must maintain to absorb losses and provide for recapitalisation, in the event of resolution. The purpose of MREL is to ensure that investors and shareholders, and not the taxpayer, absorb losses when a firm fails. The UK already has in place a MREL framework in line with international standards (the Financial Stability Board's (FSB) Total Loss Absorbing Capacity (TLAC) standards).

1.6 BRRDII states that the deadline for institutions and entities to comply with end-state MREL requirements shall be 1 January 2024. Given this is after the end of the Transition Period, it is right that the UK exercises its discretion about whether to transpose these requirements.

1.7 In considering the transposition of BRRDII, the government will look to build upon the UK's current resolution regime. This has been established in law through the Banking Act in 2009, the Financial Services (Banking Reform) Act 2013 and the

UK's implementation of the BRRD in 2014, in particular the Bank Recovery and Resolution (No 2) Order 2014.

1.8 The Bank of England is the UK's resolution authority, in accordance with its current role in the Banking Act. The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) will carry out the functions of the competent authorities specified in the Directive, many of which they currently undertake. HM Treasury will be the competent ministry, performing any functions specified in BRRDII.

1.9 We are consulting on the following provisions of the Directive:

- the introduction of the concepts of 'resolution entities' and 'resolution groups' which derive from the same terms used in the FSB's TLAC standard
- the power for the resolution authority to prohibit certain distributions, where the entity fails to meet its combined buffer requirement, when considered in addition to its MREL requirements
- the power for the resolution authority to suspend any contractual payment or delivery obligations after a firm is deemed failing or likely to fail, but before entry into resolution
- restrictions on the selling of subordinated eligible liabilities to retail clients
- amendments to the requirements on the contractual recognition of bail-in, to address circumstances in which it would be legally or otherwise impractical to include a contractual term
- a requirement for entities to include, in financial contracts governed by third country law, a term by which the parties recognise that the financial contract may be subject to the exercise of powers by the resolution authority to suspend or restrict obligations

1.10 The scope of the Directive covers credit institutions, 730k investment firms[1], certain financial institutions[2], and financial holding companies, mixed financial holding companies and mixed-activity holding companies.

1.11 This consultation seeks views on the UK's approach to the transposition of BRRDII, particularly in areas where a policy choice remains in transposition. It does not attempt to cover all aspects of transposition. Where the consultation document expresses the government's views, these are preliminary views and are subject to further consideration.

1.11.1 The government is also aware that as the legislation will form part of "retained EU law" at the end of the Transition Period, the government will need to use powers under section 8 of the European Union (Withdrawal) Act 2018 (as amended by the European Union (Withdrawal Agreement) Act 2020) to correct any deficiencies arising in retained EU law and ensure that the UK maintains a

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[1] As defined in point (2) of Article (1) of Regulation (EU) No 575/2013 (the Capital Requirements Regulation) and subject to the initial capital requirement laid down in Article 28(2) of Directive 2013/36/EU (the Capital Requirements Directive).

[2] i.e. financial institutions that are subsidiaries of credit institutions or investment firms, or of financial holding companies.

functioning regulatory and legal framework following the end of the Transition Period.

1.12 Responses are requested by 11 August 2020. The government cannot guarantee that responses received after this date will be considered.

1.13 This document is available electronically at www.gov.uk/treasury. You may make copies of this document without seeking permission. Printed copies of the document can be ordered on request from the address below.

1.14 Responses can be sent by email to BRRDII.Consultation@hmtreasury.gov.uk. Alternatively, they can be posted to:

Resilience and Resolution Team

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

1.15 When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make clear who the organisation represents and, where applicable, how the views of members were assembled.

Processing of personal data and confidentiality

1.16 This notice sets out how we will use your personal data, and your rights under the Data Protection Act 2018 (DPA).

Your data (Data Subject Categories)

1.17 The personal information relates to members of the public, parliamentarians, and representatives of organisations or companies.

The data we collect (Data Categories)

1.17.1 Information may include the name, address, email address, job title, and employer of the correspondent, as well as their opinions. It is possible that respondents will volunteer additional identifying information about themselves or third parties.

Purpose

1.17.2 The personal information is processed for the purposes of obtaining the opinions of members of the public and representatives of organisations and companies, about departmental policies, proposals, or generally to obtain public option data on an issue of public interest.

Legal basis of processing

1.17.3 The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in the HM Treasury. The task is consulting on departmental policies or proposals, or obtaining opinion data, in order to develop good effective policies.

Who we share your responses with (Recipients)

1.17.4 Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).

1.17.5 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

1.17.6 Where someone submits special category personal data or personal data about third parties, we will endeavour to delete that data before publication takes place.

1.17.7 Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at: https://www.gov.uk/government/organisations.

1.17.8 As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we will hold your data (Retention)

1.17.9 Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.

1.17.10 Personal information in responses that is not published will be retained for three calendar years after the consultation has interest.

Special data categories

1.17.11 Any of the categories of special category data may be processed if such data is volunteered by the respondent.

Basis for processing special category data

1.17.12 Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: The processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a government department.

1.17.13 This function is consulting on departmental policies or proposals, or obtaining opinion data, to develop good effective policies.

Your rights

1.17.14 You have the right to:

- request information about how your personal data are processed, and to request a copy of that personal data.

- request that any inaccuracies in your personal data are rectified without delay.
- request that your personal data are erased if there is no longer a justification for them to be processed.
- in certain circumstances (for example, where accuracy is contested) request that the processing of your personal data is restricted.
- object to the processing of your personal data where it is processed for direct marketing purposes.

Complaints

1.17.15 If you have any concerns about the use of your personal data, please contact us via this mailbox: privacy@hmtreasury.gov.uk

1.17.16 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office

Wycliffe House

Water Lane

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0303 123 1113

casework@ico.org.uk

Contact details

1.17.1 The data controller for your personal data is HM Treasury. The contact details for the data controller are:

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1.17.2 The contact details for the data controller's Data Protection Officer (DPO) are:

DPO

1 Horse Guards Road

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SW1A 2HQ

privacy@hmtreasury.gov.uk

Chapter 2

Group resolution plans

2.1 BRRDII amends Article 2(1) of BRRD to introduce the concepts of 'resolution entities' and 'resolution groups' which derive from the same terms used in the FSB's TLAC standard.

2.2 In line with the introduction of these new concepts, BRRDII amends the requirements in Article 12 of BRRD on resolution plans to identify for each group the resolution entities and the resolution groups. It also requires a group which comprises of more than one resolution group to set out the resolution actions for the resolution entities of each resolution group and the implications of those actions on both other group entities belonging to the same resolution group and other resolution groups.

Box 2.A: Group resolution plans

1. Do you have any comments on the amendments made by BRRDII to group resolution plans?

Chapter 3

Power to prohibit certain distributions

3.1 The new Article 16a provides resolution authorities with the power to impose a maximum distributable amount (MDA) restriction on a firm, where it has insufficient resources to meet its combined buffer requirement, in addition to its MREL requirements. An MDA would place restrictions on the ability of a firm to distribute earnings, in the form of dividends on Common Equity Tier 1 capital, obligations to pay variable remuneration payments or discretionary pension benefits, and coupon payments to holders of Additional Tier 1 instruments.

3.2 During the first nine months of a breach of a firm's combined buffer requirement in addition to its MREL requirements, the resolution authority, following consultation with the competent authority, has discretion as to whether to apply this MREL related MDA regime, taking into account a number of specified factors. This assessment must be carried out monthly while the breach exists.

3.3 If the breach persists for more than nine months, the MDA restriction becomes mandatory, other than in a financial crisis scenario in which there is serious disturbance to the functioning of financial markets which would prevent firms from meeting their requirements.

Box 3.A: MREL related Maximum Distributable Amounts regime

1. Do you have any comments on the proposed introduction of a power for the resolution authority to prohibit certain distributions relating to MREL?

Chapter 4

Powers to address or remove impediments to resolvability

4.1 BRRDII amends the powers in Article 17 of BRRD to address or remove impediments to resolvability, providing additional detail on circumstances where there is an impediment to resolvability.

4.2 The Directive also amends the powers of resolution authorities to remove impediments to resolvability to include requiring a firm to change the maturity profile of their MREL.

Box 4.A: Powers to address or remove impediments to resolvability

1. Do you have any comments on the proposed amendments to the powers to address or remove impediments to resolvability?

Chapter 5

Moratorium powers

Amendments to the 'in-resolution' moratorium power

5.1 Under Article 69 of BRRD, the Bank of England currently has the power to suspend the payment and delivery obligations of a firm which is in resolution, in order to allow some space to facilitate the application of resolution tools. The UK previously transposed this in-resolution moratorium power through the creation of new sections 70A and 70D of the Banking Act 2009.

5.2 BRRDII amends Article 69 of BRRD to extend the scope of this 'in-resolution' moratorium power to permit the suspension of eligible deposits.

5.3 The Directive specifies that resolution authorities should assess carefully the appropriateness of applying this power to eligible deposits, and in particular covered deposits held by natural persons and micro, small and medium-sized enterprises.

5.4 Where this suspension power is exercised in respect of eligible deposits, states subject to BRRD may provide that resolution authorities ensure that depositors have access to an appropriate daily amount of funds, to ensure that they do not enter into financial difficulties.

New 'pre-resolution' moratorium power

5.5 BRRDII also establishes a pre-resolution moratorium power through the new Article 33a. This article sets out that the resolution authority shall have the power to suspend payment or delivery obligations regarding any contract to which a firm is a party, once the firm is deemed to be 'failing or likely to fail' but before that firm has entered into resolution.

5.6 As such, Article 33a sets out that this 'pre-resolution' moratorium power is available to resolution authorities, subject to all of the following conditions being met:

- a determination has been made that a firm is failing or likely to fail
- there is no immediately available private sector measure that would prevent the failure of the firm
- the exercise of the suspension power is considered necessary to avoid further deterioration of the financial conditions of the firm
- the exercise of the suspension power is either necessary to determine that resolution action is necessary in the public interest or is necessary to ensure the effective application of one or more resolution tools

5.7 The suspension power does not apply to systems and operators of systems, central counterparties (CCPs) and central banks.

5.8 As with the amended 'in-resolution' moratorium power, the resolution authority may apply the power to suspend eligible deposits. Resolution authorities should similarly assess carefully the appropriateness of applying this power to eligible deposits, and in particular covered deposits held by natural persons and micro, small and medium-sized enterprises.

5.9 As set out within Article 69, states subject to BRRD may provide that resolution authorities ensure that depositors have access to an appropriate daily amount of funds to ensure that they do not enter into financial difficulties.

5.10 When employing this pre-resolution moratorium power, resolution authorities must take into account the circumstances of each individual case and the potential impact of the exercise of this power on the functioning of financial markets.

5.11 The duration of any suspension should be limited to a maximum of two business days. Up to that maximum, the suspension could continue to apply after the resolution decision is taken. The in-resolution moratorium power set out in Article 69 must not be applied subsequently to the pre-resolution moratorium power.

Box 5.A: Moratorium powers

1. Do you have any comments on the proposed amendments to the 'in-resolution' moratorium power?
2. Do you have any comments on the proposed introduction of a 'pre-resolution' moratorium power?
3. Do you have any comments on the application of both the 'in-resolution' moratorium power and 'pre-resolution' moratorium power on eligible deposits?

Chapter 6

Selling of eligible liabilities to retail clients

6.1 The new Article 44a of BRRDII introduces restrictions on the selling of TLAC and MREL eligible liabilities to retail clients. For these purposes, a retail client is defined as a client who is not a professional client or an eligible counterparty. A professional client is defined as an entity required to be authorised or regulated to operate in financial markets.

6.2 BRRDII establishes that a firm may only sell TLAC eligible liabilities, as defined within the Capital Requirements Regulation II (CRRII), where certain conditions are met.

6.3 The seller must perform a suitability test, in accordance with Article 25 of the Markets in Financial Instruments Directive II (MiFID II), and be satisfied that the liabilities are suitable for the retail client. The seller must then document this suitability.

6.4 The seller must also ensure, if the retail client has a financial instrument portfolio of less than EUR 500 000 at the time of the purchase, that the client does not invest an aggregate amount exceeding 10% of the portfolio in eligible liabilities, and that the initial investment in these liabilities is at least EUR 10 000.

6.5 States subject to the BRRD may also choose to extend these conditions to other MREL eligible instruments, beyond those qualifying as TLAC under CRRII. TLAC applies to Globally Systemically Important Institutions (G-SIIs) only, while MREL applies to the broader population of institutions (G-SIIs and non-GSIIS). For G-SIIs, MREL is composed of the TLAC requirement set out within CRRII and where appropriate, an institution-specific MREL add-on set out within BRRDII.

6.6 States may however, considering the market conditions, practices and consumer protections within their state, as an alternative to the above requirements, simply set a higher minimum investment amount of at least EUR 50,000, for retail investors to purchase subordinated eligible liabilities.

6.7 Where the total asset value of a firm is lower than EUR 50 billion, states are permitted to disapply all of the above restrictions on the selling of MREL to retail clients, other than the requirement that the initial investment amount is at least EUR 10 000.

6.8 The above requirements shall not apply retroactively to liabilities issued before 28 December 2020.

Box 6.A: Selling of eligible liabilities to retail clients

1. Do you have any comments on the requirements around the sale of eligible liabilities to retail clients?

Chapter 7

Contractual recognition of bail-in

7.1 Article 55 of BRRD relates to liabilities within the scope of the bail-in powers but governed by the law of a third country. It requires that any such liabilities, issued or entered into after implementation, include a contractual term which states that the liability may be subject to the write-down and conversion powers, and that the creditor agrees to be bound by any actions of the resolution authority in relation to the liability.

7.2 BRRDII updates Article 55 to recognise that in practice, this requirement can be difficult to implement. It therefore specifically addresses the scenario in which it is impracticable for entities to include such contractual recognition clauses within liabilities contracts governed by third country law, and allows firms to not include such contractual terms in certain unsecured liabilities contracts.

7.3 The UK previously implemented Article 55 of BRRD through the PRA Rulebook; Contractual Recognition of Bail in and FCA Handbook (IFPRU 11.6.3R) as well as in sections 3A and 48B of the Banking Act, 2009. Current UK PRA policy on the inclusion of contractual recognition language into liabilities contracts governed by third country law already permits firms to not include contractual terms into certain contracts where this would be impracticable.

7.4 The resolution authority must be notified of any impracticability decision made by an entity and validate this decision. In the event that the resolution authority concludes that a decision to omit a contractual recognition clause on the basis of impracticability is not justified, it shall request the inclusion of a contractual term.

7.5 Where a BRRD entity's liabilities which are excluded from bail in, when combined with third-country liabilities which do not contain a contractual clause, amount to more than 10% of liabilities within that class, the resolution authority must assess the impact of this upon the firm's resolvability. Where the resolution authority considers this to represent an impediment to resolvability, it should apply its powers to remove impediments to resolvability, as set out within Article 17(5) of BRRD, which the UK transposed into new sections 3A and 3B of the Banking Act, 2009 (see also Part 6 of the Bank Recovery and Resolution (No 2) Order 2014).

7.6 The updated Article 55 also provides the resolution authority with the power to exempt from the contractual recognition of bail-in requirement, entities for which their MREL requirement is equal only to their loss-absorption requirement, and are therefore not in scope of bail-in.

7.7 Where an entity does not include a contractual term, this should not prevent the resolution authority from exercising the write down and conversion powers in relation to that liability.

Box 7.A: Contractual recognition of bail-in

1. Do you have any comments on the amendments made by BRRDII to requirements for the contractual recognition of bail-in?

Chapter 8

Contractual recognition of resolution stay powers

8.1 Under the new Article 71a, BRRDII introduces a requirement for in scope entities to include a contractual term within financial contracts governed by third-country law, recognising that the contract may be subject to the exercise of resolution powers by the resolution authority to suspend the firm's payment or delivery obligations, or to suspend a counterparty's termination or security enforcement rights.

8.2 Where an entity does not include the contractual term, this should not prevent the resolution authority from applying their moratorium powers to suspend payment or delivery obligations or applying their powers to restrict the enforcement of security instruments, or suspend termination rights.

8.3 States subject to the BRRD may also require that parent undertakings ensure that their third-country subsidiaries include, within relevant financial contracts, terms to mandate that they cannot engage in early termination, suspension, modification, netting, the exercise of set-off rights or the enforcement of security interests on those contracts, should the resolution authority apply resolution powers to suspend or restrict obligations at the parent undertaking level.

Box 8.A: Contractual recognition of resolution stay powers

1. Do you have any comments on the requirements for the contractual recognition of stay powers?

HM Treasury contacts

This document can be downloaded from
www.gov.uk

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