



HM Treasury

Bank Recovery and Resolution Directive (BRRD) implementation:

response to consultation

November 2016



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1 Introduction

1.1 The Treasury launched a consultation on 17 December 2015 entitled 'Bank Recovery and Resolution Directive (BRRD) implementation' ('the consultation'). The consultation closed on 25 February 2016. The government received 5 responses. The consultation can be found on the gov.uk website.

1.2 This document gives a brief summary of the responses submitted and the government's position following the consultation.

1.3 The Bank Recovery and Resolution Directive (BRRD) establishes a common approach within the European Union (EU) to the recovery and resolution of banks and investment firms.

1.4 The UK's special resolution regime (SRR) provides the Bank of England, the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and the Treasury with tools to protect financial stability by managing the failure of financial sector firms. The SRR was recently updated in January 2015 to transpose the BRRD, following a consultation published in July 2014.

1.5 The government consulted on a small number of changes that would clarify and strengthen the UK's transposition of the BRRD in the following areas:

- Default event provisions and contractual write-down or conversion
- Stand-alone powers for the regulators to require the removal and replacement of directors and senior managers in situations where there has been a significant deterioration in the financial situation of a firm, or where there are serious infringements of law or administrative irregularities
- Powers for the Bank of England to act independently to resolve a UK branch of a third country institution

1.6 Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the government will continue to negotiate, implement and apply EU legislation.

2 Summary of responses

2.1 The government received 5 responses to the 'Bank Recovery and Resolution Directive (BRRD) implementation' ('the consultation'). This document sets out the questions asked, a summary of the responses received and the position taken by the government following consultation.

Contractual write down and conversion

Question 1. Do you agree with the proposed approach to contractual write-down and conversion?

2.2 The effectiveness of early intervention and stabilisation measures could be undermined if they resulted in the termination of the firm's key contracts. As such, section 48Z of the Banking Act 2009 ensures that a crisis prevention measure or crisis management measure will not trigger any default event provision in any contract to which an institution under resolution, its subsidiaries, or a member of the same group is a party, provided the firm continues to meet its substantive obligations in the contract.

2.3 The consultation set out there may be circumstances where it is advantageous for contracts to include clauses that are activated by the use of a crisis prevention measure or a crisis management measure. The consultation proposed amending section 48Z of the Banking Act 2009 to ensure that certain instruments can take effect in accordance with their terms, to the extent specified by the resolution authority (the Bank of England or Treasury as the case may be), to support the stabilisation of the firm.

2.4 Consultation respondents were broadly supportive of the policy intention. Respondents asked for greater clarity over which contracts or contractual provisions would be permitted to take effect. In response to this, the government will provide further guidance in Chapter 7 of the Special Resolution Regime Code of Practice on which types of contracts could include clauses that are activated by the use of a crisis prevention or management measure.

2.5 In general, default event provisions will not be triggered by a crisis prevention measure or crisis management measure. The exceptions in the proposed amendment of section 48Z will only apply to a narrow range of contracts including for example contractual bail-in instruments, internal minimum requirement for own funds and eligible liabilities (MREL) instruments and service contracts to support operational continuity in a firm following resolution.

Early intervention powers

Question 2: Do you support the inclusion of specific powers for the PRA and FCA to appoint a temporary manager, and the proposals to extend section 48Z of the Banking Act 2009 to cases in which a temporary manager is appointed'?

Question 3: Do you agree with the government's proposal to use the term "temporary manager" rather than "temporary administrator"?

2.6 The consultation included two new stand-alone powers for the regulators to require the removal and replacement of directors and senior managers in accordance with Article 28 of the BRRD, and to appoint temporary administrators in accordance with Article 29. In addition, the consultation proposed measures to enable the PRA and FCA to convene a meeting of shareholders, if they have required the management body of the failing firm to do so, and the management body has failed to comply with that requirement.

2.7 These proposals were supported by respondents. The reference to temporary managers, instead of temporary administrator was also welcomed.

Independent resolution power over branches

Resolution powers

Question 4: Do you agree that the proposed transfer and bail-in powers could be an effective way to resolve a branch independently of the third country resolution authority?

Question 5: What, if any, further resolution powers could be effective in an independent resolution of a UK branch of a third country institution?

2.8 Article 96 of the BRRD requires that where an European Economic Area (EEA) resolution authority has refused to recognise third country resolution proceedings, or where the third country resolution authority has not commenced resolution proceedings which affect the branch, and action is in the public interest, the EEA resolution authority has the powers necessary to act in relation to the branch, independently of the third country resolution authority.

2.9 In the consultation, the government proposed the following backstop powers for the Bank of England to independently resolve the UK branch of a third country institution:

- powers to transfer some or all of the assets, rights and liabilities (“the business of the branch”) to a private sector purchaser, to a bridge bank or to an asset management vehicle (AMV)
- the power to bail in liabilities in connection with the transfer to the private-sector purchaser, the bridge bank, or the AMV

2.10 Respondents were broadly supportive of the government’s approach, noting that it recognized the backstop natures of the powers, while ensuring the Bank of England has the necessary powers to resolve the UK branch of a third country institution, in the extraordinary scenario it would need to act independently. Respondents did not raise any further tools which would be needed.

Definition of ‘business of the branch’

Question 6: Do you have any comments on the proposed definition of the ‘business of the branch’?

2.11 For the purposes of the independent resolution powers, the government consulted on the following definition of ‘business of a UK branch’:

- Any property in the United Kingdom of the relevant third country institution, and
- Any rights and liabilities of the relevant third country institution arising as a result of the operations of a UK branch.

2.12 Two respondents raised concerns over the broad nature of the definition. One respondent noted that independent resolution action over the UK branch of a third country institution could disrupt the continuity of services across the broader branch network.

2.13 The government believes a broad definition of ‘business of the branch’ is required, to ensure that, in the exceptional situation the Bank of England needs to use the proposed powers, they can do so effectively. The Bank of England would need to have regard to the financial stability implications on EEA and third countries when it is considering the use of stabilisation powers. In addition, the Bank of England could apply continuity provisions to require the transferee to continue to perform the obligations. As such, the impact of independent resolution action on the UK branch of a third country institution on the broader branch network is expected to be limited.

2.14 The government therefore proposes continuing with the proposed definition of the “business of the branch”.

Conditions for use

Question 7: Do you have any comments on the proposed conditions for making a property transfer instrument under the proposed new powers for independent resolution of branches?

2.15 In the consultation, the government proposed placing the following four conditions on the use of these powers:

Condition 1: That the relevant third country institution is failing or likely to fail, that is:

- it is failing, or likely to fail, to satisfy the threshold conditions (specified in section 55B(1) of FSMA 2000) in circumstances where that failure would justify the variation or cancellation by the PRA under section 55J of FSMA 2000 of the institution’s permission under Part 4A of that Act to carry on one or more regulated activities in the United Kingdom,
- it is unable or unwilling to pay its debts or other liabilities owed to EEA creditors or otherwise arising from the business of a UK branch as they fall due and the Bank of England is satisfied that no third country resolution action or normal insolvency proceedings have been initiated in relation to such institution, or
- paragraph (b) will, in the near future, apply to the third country institution

Condition 2: that it is not reasonably likely that action will be taken by or in respect of the third country institution that will result in Condition 1 ceasing to be met:

Condition 3: that making the property transfer instrument is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives;

Condition 4: that –

- third country resolution action has been taken, or the Bank of England has been notified that such action will be taken, in relation to the third country institution, and the Bank of England has or proposes to refuse to recognise such action for one or more of the reasons specified in section 89H(4) of the Banking Act 2009 (recognition of third country resolution actions), or
- Third country resolution action has not been, and is not likely to be, taken in relation to the third country institution.

2.16 The government also proposed that the Bank of England would be able to use independent resolution powers only if:

- The Treasury has approved the making of an instrument,
- The PRA or the FCA (as the case may be) is satisfied that Condition 1 is met, and
- The Bank of England is satisfied that Conditions 2, 3 and 4 are met.

2.17 Respondents agreed with the broad approach. The government will provide further guidance in Chapter 10 of the Special Resolution Regime Code of Practice on how the Bank of England will judge whether conditions for the use of these powers are satisfied for branches.

Extension of safeguards and determination of insolvency treatment

Question 8: Do you agree to the proposed extension of the safeguards?

Question 9: Do you agree that the insolvency treatment against which “no creditor worse off” compensation should be calculated is the third country insolvency law, except where this is to the serious detriment of local creditors?

Question 10: Do you agree that HMT should have the discretion to determine (whether themselves or by tasking the valuer with this role) if local insolvency law should be applied for the purposes of assessing the insolvency treatment instead of third country law?

2.18 The government proposed that safeguards that apply in connection with the exercise of the property transfer and bail-in powers for firms established in the UK should extend to the application of powers in connection with branches. This includes the “no creditor worse off” safeguard. Respondents supported the extension of these safeguards.

2.19 Calculation of “no creditor worse off” compensation requires an independent valuer to be appointed, to assess the “actual treatment” of the shareholder or creditor as a result of the resolution, and the treatment that the shareholder or creditor of the failing bank would have received had the bank been put into insolvency rather than stabilised (“the insolvency treatment”). Therefore, determining what, if any, “no creditor worse off” compensation is due in the event of an independent stabilisation of a UK branch of a third country institution would require identification of the appropriate insolvency treatment, to act as the scenario against which compensation is calculated.

2.20 The consultation set out that the insolvency treatment against which NCWO is calculated is the third-country insolvency law, unless this is to the “serious detriment” of local creditors. Two respondents said it was not clear how “serious detriment” would be judged.

2.21 Noting these concerns, the government proposes to apply the insolvency law of the relevant third country, unless it would be considered just and equitable for the company to be wound up in the United Kingdom under the Insolvency Act 1986, in accordance with section 221 of that Act. Referring to the “just and equitable” test in the Insolvency Act would deliver a similar outcome, ensuring necessary discretion, and tie it to legal precedent.

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