



HM Treasury

# Transposition of the Bank Recovery and Resolution Directive (BRRD) II: response to consultation

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October 2020



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ISBN: 978-1-913635-76-3 PU: 3009

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# Chapter 1

## Introduction

- 1.1 In June 2020, HM Treasury published the consultation document, 'Transposition of the Bank Recovery and Resolution Directive II'.
- 1.2 The consultation document sought views on the UK's approach to the transposition of the Bank Recovery and Resolution Directive II (BRRDII), particularly in areas where a policy choice remained in transposition. It did not attempt to cover all aspects of transposition.
- 1.3 We consulted on the following provisions of the Directive:
1. the introduction of the concepts of 'resolution entities' and 'resolution groups' which derive from the same terms used in the Financial Stability Board (FSB)'s Total Loss Absorbing Capacity (TLAC) standard
  2. 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 minimum requirement for own funds and eligible liabilities (MREL) requirements
  3. 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
  4. restrictions on the selling of subordinated eligible liabilities to retail clients
  5. amendments to the requirements on the contractual recognition of bail-in (CROB), to address circumstances in which it would be legally or otherwise impractical to include a contractual term
  6. 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
- 1.4 The consultation ran from 23 June 2020 to 11 August 2020, during which time the government received 9 written responses (see Annex A for a list of respondents). This document summarises the responses received from the consultation, sets out the Government's approach to implementation of the Directive, and provides an update on the forthcoming legislation.

### Bank Recovery and Resolution Directive II (BRRDII)

- 1.5 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 bank resolution

regime across the EU. The resolution regime provides the financial authorities (the Financial Conduct Authority (FCA), the Bank of England, and HM Treasury) with powers to manage the failure of financial institutions in a way that protects depositors and maintains financial stability, while limiting the risks to public funds. The Directive updates the powers that financial authorities have to resolve a failing bank.

- 1.6 During the Transition Period (TP), 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.
- 1.7 The Directive also updates the MREL framework. 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. These amendments intend to bring the harmonised EU resolution and MREL frameworks into conformity with international standards. The substantive provisions in BRRDII are set out below.
- 1.8 The Directive amends BRRD to introduce the concepts of ‘resolution entities’ and ‘resolution groups’ which derive from the same terms as used in the FSB’s TLAC standard. These concepts are used to determine TLAC requirements. A resolution entity is identified by the resolution authority as an entity with respect to which resolution tools, including the TLAC requirement, will be applied. A resolution group is a resolution entity together with any subsidiaries that are not themselves resolution entities or subsidiaries of another resolution entity.
- 1.9 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 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.
- 1.10 The new Article 16a in BRRDII 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. BRRDII also 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.
- 1.11 The new Article 44a of BRRDII introduces restrictions on the selling of subordinated 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. BRRDII establishes that a firm may only sell subordinated eligible liabilities, as defined within BRRDII, where certain conditions are met.

- 1.12 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. 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.
- 1.13 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.



# Chapter 2

## Summary of responses

- 2.1 The Government received 9 written responses to the consultation. The consultation asked 9 questions, the responses to which are summarised below, as well as summarising additional areas flagged in the consultation.

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

- 2.2 Most respondents did not respond to this question. The respondents who did respond raised no issues with these amendments.

### Question 2: Do you have any comments on the proposed introduction of a power for the resolution authority to prohibit certain distributions relating to MREL?

- 2.3 One respondent noted that the PRA already has rules in place which forbid double counting of CET1, and that the MREL-MDA restrictions in BRRDII would change this current approach. They viewed the concept of MREL-MDA as flawed, and that it risked turning a short-term liquidity event arising from a market shutdown into a more serious capital event.

### Question 3: Do you have any comments on the proposed amendments to the powers to address or remove impediments to resolvability?

- 2.4 One respondent commented on this provision and noted that the Bank of England has powers under Section 3A of the Banking Act 2009 to direct banks to take certain actions to remove impediments to resolvability, and it was not clear what the additional BRRDII provision would add to the resolution toolkit. They commented that these powers would only be used when a proportionate assessment had taken place, and the respondent would wish this to continue under the new framework.
- 2.5 The respondent asked for clear communication as to what criteria will be considered in assessing whether firms need to be instructed to change the maturity profile of MREL.

## Moratorium Powers

**Question 4: Do you have any comments on the proposed amendments to the 'in-resolution' moratorium power?**

**Question 5: Do you have any comments on the proposed introduction of a 'pre-resolution' moratorium power?**

**Question 6: Do you have any comments on the application of both the 'in-resolution' moratorium power and 'pre-resolution' moratorium power on eligible deposits?**

- 2.6 Respondents who answered questions on the pre-resolution moratorium power did not view it as necessary to achieving an effective resolution framework in the UK.
- 2.7 Two respondents noted that the introduction of a pre-resolution moratorium power may cause significant concern for counterparties and potentially be counterproductive to ensuring continuity of critical functions, creating uncertainty in the market. They did not believe that the introduction of this power was necessary to bridge the gap between a "failing or likely to fail" determination and a decision to place an institution into resolution, given the close cooperation of UK authorities, which another respondent also raised.
- 2.8 Another respondent raised concerns that due to the broader scope of moratorium powers, and the requirement to insert contractual clauses recognising these powers, contracts would be at risk of becoming inconsistent depending on the host jurisdiction.
- 2.9 These respondents also raised concerns about applying both the 'in-resolution' moratorium power and 'pre-resolution' moratorium power to eligible deposits. One respondent noted that the application of moratorium powers to retail deposits may risk undermining financial stability, due to the possibility of a three day planned suspension of access to customers' insured deposits.
- 2.10 One respondent noted that existing moratoria (and their scope) under BRRD as transposed into UK law were sufficient. Two respondents agreed that if this provision had to be transposed, then it should be sunsetted.

**Question 7: Do you have any comments on the requirements around the selling of subordinated eligible liabilities to retail clients?**

- 2.11 One respondent noted that the FCA has similar rules for retail clients in place, and that this provision should be transposed by extending these rules in a coherent way.
- 2.12 It was also noted that the UK had a choice about its ability to set a higher denomination than €50k or even £50K, but the consultation document did not indicate a preference. Two respondents noted that the amount should be specified in sterling. One respondent said that all definitions should be

completely aligned with the Markets in Financial Instruments Directive (MIFiD) definitions used to classify different counterparty types.

- 2.13 One respondent asked for clarification on whether Article 44a(1) excludes eligible liabilities issued from holding companies subject to the clean holding company requirements of the Capital Requirements Regulation II (CRRII).

### **Question 8: Do you have any comments on the amendments made by BRRDII to requirements for the contractual recognition of bail-in?**

- 2.14 Three respondents welcomed the introduction of the 'impracticability' waiver into EU law, which already exists in UK law.
- 2.15 Respondents noted that the requirement to notify the resolution authority where the addition of the clause is deemed to be 'impractical' goes beyond current UK requirements. They viewed this as being overly burdensome, and thought the UK's current approach represents a stronger regime of accountability. They also thought some of the amendments that BRRDII makes to Article 55 could weaken the regime already in place.
- 2.16 One respondent noted that the introduction of a trigger for an automatic assessment of a firm's resolvability, where more than 10% of a liability class containing eligible liabilities benefits from the use of the impracticability waiver, would not be helpful as it may negatively impact how firms approach the use of the impracticability waiver and discourage them from using it, when it would be legitimate to do so. This could result in business opportunities missed in areas where there are impracticability concerns.

### **Question 9: Do you have any comments on the requirements for the contractual recognition of stay powers?**

- 2.17 New Article 71a generated a high number of consultation responses.
- 2.18 Many respondents noted that changes to the PRA's stay rules could require a significant repapering exercise for firms, in addition to the repapering required to bring new European Economic Area (EEA) law governed agreements into compliance with PRA Stay rules by the end of 2020. They viewed the UK's existing regime on the contractual recognition of stay powers to be effective, and implemented by firms through bilateral contracts or adherence to protocols such as those developed by the International Swaps and Derivatives Association (ISDA).
- 2.19 Many respondents flagged that Article 71a requires the European Banking Authority (EBA) to develop Regulatory Technical Standards (RTS) determining the contents of the contractual recognition clause required under Article 71a. The EBA has published a consultation paper on these draft technical standards. Respondents raised concerns about the approach that the EBA has taken in its draft RTS and the potentially significant work that would result from implementation of the EBA RTS as currently drafted.

## Additional concerns

- 2.20 Respondents raised concerns with regards to transposition of the amendments to Article 48(7) which will change the priority of certain debts in insolvency. They noted the potential and unclear impact this could have on existing and new instruments and more widely on investor expectations and the market, including pricing and contractual terms of instruments.

# Chapter 3

## Government response

- 3.1 During the Transition Period (TP), 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. We will not transpose provisions which apply to firms after the end of the TP.
- 3.2 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.

### Transposition

- 3.3 We are transposing BRRDII either via secondary legislation or regulator rules, in line with our previous approach to transposition for BRRD.
- 3.4 The two provisions we are intending to transpose into regulatory rules includes the new Article 44a of BRRDII using FCA rules. We are also intending to transpose the new Article 71a by simply including the new pre-resolution moratorium power within the definition of 'crisis management measure' in the 2009 Banking Act. This will mean that no changes of substance are required to the PRA's stay rules, and so will not require firms that are already compliant with the PRA's stay rules to repaper contracts.
- 3.5 As the legislation will form part of "retained EU law" at the end of the TP, we are using our 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 functioning regulatory and legal framework following the end of the TP.

### Non-transposition

- 3.6 As laid out in our consultation document, in our transposition of BRRDII we are not intending to implement the requirements in the Directive that do not need to be complied with by firms until after the end of the TP, in particular Article 1(17) which revises the framework for MREL requirements across the

EU. The UK already has in place a MREL framework in line with international standards (the FSB's TLAC standards). 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 TP, it is right that the UK exercises its discretion about whether to transpose these requirements.

## Sunseting

- 3.7 In our transposition of BRDDII we have also considered which provisions would not be suitable for the UK resolution regime after leaving the EU, whilst still maintaining prudential soundness and other important regulatory outcomes such as consumer protection and proportionality. We have also taken into account concerns raised in consultation responses on the potential risks to financial stability and consumers.
- 3.8 As a result, we are intending to include sunset clauses in our secondary legislation transposing BRRDII for the following provisions. These provisions will cease to have effect in the UK from 1 January 2021:
- Article 1(6) of BRRDII which inserts a new Article 16a in BRRD to provide the resolution authority with the power to prohibit an entity from distributing more than the 'Maximum Distributable Amount' relating to the minimum requirement for own funds and eligible liabilities (M-MDA), where the entity fails to meet the combined buffer requirement, subject to certain conditions. The article also sets out the way in which the M-MDA should be calculated
  - Article 1(12), which inserts a new Article 33a in BRRD to introduce a pre-resolution moratorium power. The inclusion of the pre-resolution moratorium power within the definition of 'crisis management measure' in the 2009 Banking Act will also be sunsetted
  - Article 1(20) of BRRDII which introduces Article 48(7) of BRRD, making changes to priority of debts in insolvency
  - Article 1(21) of BRRDII, which updates Article 55 of BRRD on the contractual recognition of bail-in. The existing PRA Rules on CROB will be revoked from 28 December for the remainder of the TP and new PRA Rules will have effect from 1 January 2021. The PRA will conduct a public consultation on changes to PRA Rules on CROB
  - Article 1(30) which amends the existing in-resolution moratorium power under Article 69 of BRRD
- 3.9 We are also intending to revoke any regulatory technical standards (RTS) and implementing technical standards (ITSs) which relate to provisions not implemented or not suitable for the UK that are developed by the EBA and adopted by the EU Commission by the end of the TP.

# Chapter 4

## Next steps

- 4.1 The Government consulted with the Bank of England, the PRA and the FCA throughout the drafting of this order.
- 4.2 The statutory instrument for BRRDII will be shortly laid in Parliament to meet the EU's deadline for transposition of 28 December 2020.

# Annex A

## List of respondents

The Association for Financial Markets in Europe (AFME)

Building Societies Association (BSA)

The Bank of New York Mellon

Financial Markets Law Committee (FMLC)

Herbert Smith Freehills

International Swaps and Derivatives Association (ISDA)

International Securities Lending Association (ISLA)

Lloyds Banking Group

UK Finance



## HM Treasury contacts

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