HM Treasury

Transposition of the Bank Recovery and Resolution Directive:

response to the consultation

March 2015

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1 Introduction

1.1 The Treasury launched a consultation on 23 July 2014 entitled 'Transposition of the Bank Recovery and Resolution Directive ('the consultation'). The consultation began on 23 July and closed on 28 September 2014. The government received 14 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. The government's transposition of the Bank Recovery and Resolution Directive (BRRD) was informed by these responses and the government has now transposed the requirements of the directive into UK law.

1.3 The BRRD was adopted on 15 April 2014 and published in the EU Official Journal on 12 June 2014. The transposition deadline was 31 December 2014. In order to transpose the BRRD into UK law, a number of statutory instruments subject to the affirmative resolution procedure were laid before Parliament. These were:

- The Bank Recovery and Resolution Order 2014
- The Banks and Building Societies (Depositor Preference and Priorities) Order 2014
- The Banking Act 2009 (Restriction of Special Bail-in Provision etc.) Order 2014
- The Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations 2014

1.4 These orders were laid before Parliament on 24 November 2014, debated on 15 December 2014 and came into force on 1 January 2015.

1.5 The statutory instruments subject to the negative resolution procedure were also made as part of the transposition. These were:

- The Bank Recovery and Resolution (No.2) Order 2014
- The Building Societies (Bail-in) Order 2014

1.6 These were laid on 19 December 2014 and came into force on 10 January 2015.

1.7 These orders made a number of amendments to the Banking Act 2009 ('the Banking Act'), which requires the government to publish a code of practice. The code of practice gives further detail on the powers contained within the legislation and guidelines on how the powers are expected to be used. A revised code of practice was published on 12 March 2015. It reflects the changes made by the above statutory instruments as part of transposition of the BRRD, but also other changes to the Banking Act since it was first introduced, such as changes to the regulatory architecture. The revised code of practice can also be found on the gov.uk website.

2 Summary of responses

2.1 The government received 14 responses to the 'Transposition of the Bank Recovery and Resolution Directive' consultation ('the consultation'). This document sets out the questions asked, a summary of the responses received and the position taken by the government following consultation.

Question 1. Do you agree that the powers to remove impediments to resolvability should only extend to mixed activity holding companies where subsidiary institutions are not held directly or indirectly by an intermediate financial holding company, with the exception of the power to require a mixed activity holding company to establish an intermediate financial holding company?

2.2 In order for resolution plans to be credible and feasible, firms may be required to remove impediments to orderly resolution or liquidation that have been identified by the Bank of England as part of the resolvability assessment. The firm will initially have an opportunity to propose measures intended to address any identified impediments itself. If the Bank of England does not consider these measures adequate, then it has been given powers to directly, or indirectly through the Prudential Regulatory Authority (PRA) or Financial Conduct Authority (FCA), require the firm to take alternative measures in order to remove these impediments. The government's view was that powers should only extend to mixed activity holding companies where their subsidiary institutions are not held directly or indirectly by an intermediate financial holding company.

2.3 Respondents to this question all agreed that this should be the case. The government therefore proceeded with its proposed approach; the legislation, now in force, applies to an institution authorised for the purposes of the Financial Services and Markets Act 2000 (FSMA) by the PRA or FCA and financial holding companies or mixed financial holding companies. In order to deal with situations where there is no intermediate financial holding company, the government also included the power for the Bank of England to direct a mixed activity holding company to establish an intermediate financial holding company. The newly-established intermediate financial holding company would then be subject to the powers to remove impediments to resolvability. The relevant provisions can be found in section 3A of the Banking Act.

Question 2. Do you agree with the proposal to model the right of appeal on section 55Y of the Financial Services and Markets Act 2000 (FSMA)?

2.4 Article 85 of the BRRD requires that there is a right of appeal against a decision to take a crisis prevention measure, as defined in Article 2(1)(101) of the BRRD.[1] The consultation proposed that this process should be modelled on the right of appeal to the Tribunal in respect of the use of own-initiative powers under section 55Y of FSMA. The government does not intend to implement the option for member states in Article 85(1) of requiring an *ex ante* judicial approval of crisis prevention or crisis management measures[2].

2.5 Generally, respondents agreed that the right of appeal should follow the process set out in section 55Y of FSMA, although some respondents raised concerns that there are very few provisions in FSMA with respect to the enforcement process for the PRA and FCA. The government elected to proceed with its proposed approach. Article 67 of the Bank Recovery and Resolution (No.2) Order 2014 contains the provisions for the right of appeal.

[1] A crisis prevention measure means the exercise of powers to direct removal of deficiencies or impediments to resolvability

[2] A crisis management measure means resolution action or the appointment of a special manager.

Question 3. Should the Bank of England be given enforcement powers in relation to resolution?

2.6 In order to ensure that there are appropriate mechanisms in place to effectively enforce any requirement imposed by the Bank of England in accordance with the BRRD, the consultation asked whether or not direct enforcement powers should be given to the Bank of England. These powers would be modelled on the current enforcement powers of the PRA, FCA and Bank of England (as regulator of central counterparties (CCPs)) under FSMA, with analogous safeguards and procedures also drawn from FSMA.

2.7 Respondents generally disagreed that the Bank of England should be given enforcement powers. They noted that, provided that the PRA had a full set of enforcement powers relating to resolution, it would not be necessary for the Bank of England to also have these powers. Respondents were also concerned that giving enforcement powers to the Bank of England may create a 'triple peaks' regulatory system, increasing complexity.

2.8 The government notes the concerns raised by industry but is of the view that the BRRD requires the resolution authority (the Bank of England) to have these powers. The Bank of England was therefore given a direct enforcement power as part of transposition. Further detail on enforcement is given in the response to question 4 below.

Question 4: Do you have any comments on the features of that enforcement power? Do you agree that it should be modelled on the current enforcement powers of the PRA, FCA and Bank under FSMA?

2.9 Notwithstanding the view of the majority of respondents that the Bank of England should not be given enforcement powers in relation to resolution, they generally agreed that if the Bank of England were to have these powers, they should be modelled on the current powers under FSMA.

2.10 The Bank of England was therefore given new powers that were closely modelled on the existing powers in Part 11 of FSMA. The powers, under section 83ZA to 83Z2 of the Banking Act, include the power to require a person to: provide specific information, produce specific documents, report to the Bank of England, appoint an investigator for general or specific investigator and to require a third party to produce documents. In order to ensure that the Bank of England are effectively able to enforce these requirements, they now have the right to enter a property in order to obtain information and documents. A new criminal offence has been created for anyone who intentionally obstructs the exercise of these rights.

Question 5: Do you agree that the power to require the removal of senior management should be interpreted as relating to those manager directly accountable to the Board?

2.11 Article 28 of the BRRD requires member states to ensure their regulators have the power to remove and replace the board of directors and senior management of an institutions under certain circumstances. The government proposed the insertion of a new, standalone provision in Part 4A of FSMA to allow the PRA or FCA to require an institution to remove members of its board, or senior managers directly accountable to the board. The consultation sought views on whether respondents agreed with the government's interpretation of Article 28 and the proposal to limit these powers to managers directly accountable to the board.

2.12 Respondents generally agreed with the proposed implementation of this power, noting that the board and the senior managers directly below the board in the management chain should be accountable.

2.13 However, 2 respondents thought that this was too generic and may cause confusion, suggesting that the power should only apply to the board of directors and executive directors.

They cited that changes to senior management may have an effect on the day to day running of the business and the ability to successfully implement actions necessary in resolution.

2.14 Respondents also requested further clarity as to what was meant by 'directly accountable to the board' and whether this power would apply to all senior managers or only those for which direct fault could be established and if so, how their fault would be established.

2.15 A standalone provision in FSMA was not implemented as part of transposition of the BRRD. To fulfil the requirements of the Directive, the existing powers under sections 55L and 55M of FSMA that allow the PRA and FCA to impose requirements on authorised firms may be used.

Question 6: Do you have any comments on the proposed changes to the special resolution objectives?

2.16 Article 31 of the BRRD sets out the resolution objectives. When applying the resolution tools and powers, the resolution authority must have regard to these objectives, and act in such a way that will best achieve them. In the consultation, the government did not consider that the proposed changes would have a material effect on the way the authorities would approach resolution or how they would decide on the appropriate course of action.

2.17 Respondents broadly agreed with this approach, noting that they did not think there would be a material impact on the way the authorities acted or made decisions about their approach to resolution, and that it would provide certainty regarding the alignment between the special resolution objectives in the Banking Act and those outlined in the BRRD.

2.18 The government has therefore transposed these requirements into domestic legislation. This specific provision can be found in section 4(3A) to (9) of the Banking Act.

2.19 Some respondents did suggest however, that the inclusion of the words 'in the UK' in objectives 1, 2 and 3 may not be consistent with the BRRD. They argued that including these words implied that UK authorities should only act in the interest of the UK, and were concerned this may run contrary to the objective to 'minimise the adverse effects on financial stability in the Union and its member states'.

2.20 However, as part of the transposition, the government introduced a requirement that, when taking any resolution action or applying the resolution tools, the Bank of England must have regard to the need to minimise the financial stability impact in other EEA states and have regard to the financial stability of third countries. This is specified in section 7A of the Banking Act.

Question 7: Do you have any comments on the proposed changes to the conditions for entry into resolution?

2.21 Article 32 of the BRRD specifies that a resolution action may only be taken where the following conditions are met:

- a determination has been made that the firm is failing or likely to fail
- having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector measures, including measures by an Institutional Protection Scheme (IPS) or supervisory action, including early intervention measures or the write down or conversion of relevant capital instruments taken in respect of the institution would prevent failure of the institution with a reasonable timeframe
- a resolution action is necessary in the public interest

2.22 These conditions are similar to the existing conditions in section 7 the Banking Act. The PRA (or FCA in the case of an FCA-only authorised firm) is responsible for making the determination that Condition 1 is met. Previously, the PRA (or FCA) was responsible for the determination that Condition 2 was met (in consultation with the Bank of England and the Treasury). However the BRRD requires that this determination be made by the resolution authority. The Banking Act has been amended accordingly, and the Bank of England is now responsible for making the Condition 2 determination, in consultation with the PRA, FCA and the Treasury. The Bank of England will continue to be responsible for the determination of whether the public interest test (Condition 3) is met (and must consult the PRA, FCA and the Treasury before determining that the test is met). Respondents were content with this approach.

2.23 Condition 4 is that one or more of the special resolution objectives would not be met to the same extent by the winding up of the bank (whether under Condition 2 or otherwise), as required by Article 32(5) of the BRRD.

2.24 Respondents did not opine on these changes to the conditions for resolution. Therefore, the government proceeded with the proposals set out in the consultation.

2.25 The consultation also gave details as to how the Treasury expect the conditions for resolution to apply to group companies. As set out in the BRRD and as was previously the case in the Banking Act, the resolution authority may be able to take resolution action in relation to a group company, where one or more of its subsidiaries are failing.

2.26 To facilitate resolution at the holding company level and as set out in Article 33 of the BRRD, the consultation proposed to amend the Banking Act to provide that the respective resolution authorities of the subsidiary and holding company may jointly agree that the write down and conversion of any intra-group liabilities shall be disregarded for the purpose of determining whether the conditions for resolution were met with respect to the subsidiary or the holding company.

2.27 Article 33(2) and (4) of the BRRD permits resolution authorities to take action in relation to a holding company when the resolution conditions are met with regard to one or more of its subsidiaries. The provisions in section 81B, 81ZBA and 81BA of the Banking Act are consistent with this.

2.28 Respondents sought clarification on how this decision would link with the treatment and sequencing of bail-in or capital write-down and conversion for holding companies (HoldCo) and operating companies (OpCo) and around the treatment of internal and external loss absorbing capacity (LAC).

2.29 Respondents were also concerned that losses of the subsidiary would be passed up to the holding company in a manner that may 'pierce the corporate veil'. They felt that HoldCo exposure to OpCos should be limited to their debt and equity investments in those companies. They also sought assurance that the creditor hierarchy would be followed in respect to internal LAC.

2.30 The government recognises these concerns and will continue to work closely with the Bank of England as the design of the LAC requirements is finalised.

Question 8: Do you feel that any changes to the Bank's ability to control an institution under resolution would be useful?

2.31 The consultation detailed the requirements of the BRRD regarding the special manager provision. A special manager would replace the management body of an institution under resolution and have the powers of the shareholders and of the management body, but may only

exercise such powers under the control of the Bank of England. The government considered in the consultation that the powers in sections 20, 36A and 48N implement these provisions.

2.32 Respondents agreed with the government's approach to the implementation of the special manager requirements and did not think any additional powers were needed. Therefore, the government proceeded with this provision as set out in the consultation. Sections 62B – 62E of the Banking Act implement these provisions (which replaced sections 20, 36A and 48N of the Banking Act)

Question 9: Do you agree with the proposal to allow for an 'onward asset management vehicle'?

2.33 The BRRD provides for a new tool, the asset separation tool. The asset separation tool allows resolution authorities to transfer assets, rights and liabilities of an institution to an asset management vehicle (AMV) – a vehicle created for the purpose of receiving these assets, rights and liabilities and is wholly or partially owned by public authorities. Its purpose is to manage the assets transferred to it and maximise their value through eventual sale or orderly wind down.

2.34 The government proposed to amend the Banking Act to introduce this new tool. The AMV is subject to the conditions set out in section 8ZA if the Banking Act; it can only be used in conjunction with another resolution tool and that the transfer is necessary to proper functioning of the bank or bridge bank, maximise the proceeds available for distribution and that liquidation under normal insolvency proceedings could have adverse an effect on one or more financial markets.

2.35 The government also proposed to allow for an onward asset management vehicle, in order to transfer an asset management vehicle to another company. Respondents agreed with this and government has therefore implemented the provision to allow for an onward asset management vehicle.

Question 10: Do you agree that it should be possible to use the bank administration procedure with the asset management vehicle, so that the remainder of the bank that is placed into administration can provide services to the asset management vehicle?

2.36 In the event that the bank administration procedure (BAP) is applied following a partial property transfer, the government proposed that the residual portion of a bank following a BAP transfer should be allowed to continue to provide services to the asset management vehicle. Respondents agreed with this approach. The necessary consequential amendments will be made in order to achieve this.

Question 11: Do you have any other comments on the suggested approach to transposing the asset management vehicle?

2.37 Respondents did not have any further comment on the suggested approach to transposition of the AMV.

Question 12: To the extent that liabilities in relation to pension benefits attributable to variable remuneration must be within scope of the bail-in powers, do you agree that it should be possible for the pension trustee to reduce his liability to the beneficiary accordingly? Do you have any comments on how this could be achieved?

2.38 The BRRD requires member states to introduce a bail-in tool, allowing resolution authorities to write down and/or convert into equity, liabilities of a failing bank in order to maintain the bank as a going concern and allow the issues that caused the failure to be addressed. Certain liabilities are excluded from the bail-in tool (section 48B(8) of the Banking Act. Pension liabilities are excluded from bail-in (section 48B(8)(g)), except for the variable component of remuneration that is not regulated by a collective bargaining agreement.

2.39 In general, respondents agreed with the approach set out, that pension trustees should be able to reduce their liability to beneficiaries accordingly. Respondents did note however that maintaining details of pension benefits attributable to variable remuneration would be a difficult and complex task. One respondent requested further consultation on the matter.

2.40 The government has recognised that there may be instances where continued pension trustees need to reduce their liability to beneficiaries in the event pension benefits relating to variable remuneration are bailed in. To this effect, the government may use its powers under section 75 of the Banking Act to allow pension trustees to do this. Further detail of this is given in the Banking Act code of practice in paragraph 8.24.

Question 13: Do you agree that liabilities with no fixed maturity and which are callable at any point with less than 7 days' notice should fall within the definition of a liability with an original or remaining maturity of less than 7 days?

2.41 The BRRD excludes from bail-in liabilities with an original maturity of less than 7 days owed by the bank to a credit institution or investment firm. This is reflected in section 48B(8)d of the Banking Act. Liabilities with a remaining maturity of 7 days or less arising from participation in designated settlement systems are also excluded (section 48B(8)e). The consultation considered the treatment of liabilities that have no fixed maturity date but are callable on demand, with a notice period of less than 7 days. The government proposed that these liabilities should be considered to be included within the definition of these exclusions, and therefore excluded from bail-in.

2.42 Respondents agreed with the proposed approach, commenting that it provided helpful clarity on the issue. The list of liabilities excluded from bail-in can be found section 48B of the Banking Act, as amended by the Bank Recovery and Resolution Order 2014. The government can confirm that liabilities with no fixed maturity date and that can be called on demand with less than a 7 day notice period, which otherwise meet the criteria set out in section 48B(8) (d) and (e) are regarded as in scope of those definitions.

Question 14: Do you have any other comments on the proposed changes to section 48B?

2.43 Section 48B in the Banking Act provides for special bail-in provision (as amended by the Financial Services (Banking Reform) Act 2013). Special bail-in provision allows the Bank of England to make provision cancelling or modifying a liability of the bank for the purpose of reducing, deferring or cancelling a liability of the bank. This legislation had not been commenced at the time of the consultation. The government proposed a number of amendments to section 48B to ensure consistency with the BRRD text.

2.44 Broadly, respondents were content with the proposed amendments to section 48B and welcomed the further clarity on the subject.

2.45 However, respondents raised concerns over the scope of excluded liabilities and sought further detail. These concerns related to the exclusion of pension liabilities and the exclusion on liabilities that are centrally cleared contracts (i.e. through a central counterparty (CCP)).

2.46 The consultation proposed to exclude pension liabilities 'owed as the employer under an occupational pension scheme'. Respondents were concerned that this exclusion was too narrow, citing that the term 'employer' is a defined term which needlessly restricted the scope of the exclusion and that recital 70 of the BRRD did not refer to any particular type of pension scheme, and therefore the word 'occupational' should be omitted.

2.47 The government noted these concerns and agreed that the inclusion of the word 'occupational' was too restrictive. In order to reflect this, the final wording of this provision was

changed to 'liabilities owed to a pension scheme', and therefore does not limit the scope to particular types of pension schemes.

2.48 Respondents also raised concern relating to centrally cleared contracts, and argued that they should be excluded from the scope of bail-in. Transposition of the BRRD required the government to narrow the scope of protection from that was introduced in the Financial Services (Banking Reform) Act 2013., since the exclusion is limited to 'liabilities with a remaining maturity of less than 7 days, owed to systems or operators of system designated to Directive 98/26/EC (Settlement Finality Directive)'. It was therefore necessary for the government to amend legislation in order to reflect this.

Question 15: Should the regulators' powers to require the inclusion of a contractual clause regarding recognition of bail-in extend to mixed-activity holding companies where the subsidiary institutions are held by an intermediate financial holding company?

2.49 Article 55 of the BRRD relates to liabilities within the scope of bail-in powers but governed by the law of a third country. It requires that any such liabilities issued or entered into after the transposition date include a contractual terms 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. The government is supportive of this approach and the consultation outlined that the powers for the PRA and FCA to implement this provision are already in place under sections 137G and 137A of FSMA.

2.50 The government however felt it was not necessary to extend these powers to cover mixed activity holding companies where their subsidiary institutions are held directly or indirectly by an intermediate financial holding company, since Article 33 of the BRRD prevents resolution actions being taken at the level of the mixed activity holding company. The consultation therefore proposed to extend the scope of the rule making power to mixed activity holding companies only where subsidiary institutions are not directly held by an intermediate financial holding company.

2.51 Responses to this question agreed with the government's proposed approach noting that if the mixed activity holding companies were included in the scope of the rules, it may force mixed activity holding companies to exclude banking from their activities completely in order to reduce costs and/or remain competitive in other business activities. The delay in introducing these requirements (outlined below) would allow mixed activity holding companies to put arrangements in place so that they would not be covered by these requirements, if necessary.

2.52 The government has extended the rule making power of the PRA/FCA to make rules requiring relevant mixed financial holding companies to include a contractual clause recognising bail-in. A relevant mixed activity holding company is one that has at least one subsidiary that is an institution and is not a subsidiary of a financial holding company which is also a subsidiary of a mixed activity holding company.

2.53 One respondent also noted more general concerns regarding contractual recognition of bail-in, particularly in relation to derivative contracts and contract governed by foreign law and the risk foreign courts may not uphold these contractual terms. Work is ongoing at the FSB level to enable cross-border recognition of resolution actions.

Question 16: Should the extension of the regulators' power to require mixed activity holding companies to include contractual recognition provisions in accordance with Article 55 and the MREL provision, be delayed until 1 January 2016?

2.54 The government proposed delaying the extension of the regulators powers as described in question 15, and the provision regarding the minimum requirement for own funds and eligible

liabilities (MREL) until 1 January 2016. This is in line with the flexibility provided for in Article 130 of the BRRD.

2.55 Respondents all agreed that this was the most appropriate option. In particular they noted that delaying the MREL implementation would benefit from ongoing work at the Financial Stability Board and G20 level regarding total loss absorbing capacity (TLAC). The government can confirm that the implementation of the MREL requirements, and the extension of the rule-making powers to mixed activity holding companies, will be delayed until 1 January 2016.

Question 17: Do you have any comments on the proposed approach to implementing the requirement that shareholders and creditors must make a contribution to loss absorption and recapitalisation equal to at least 8% of the total liabilities of the firm, including own funds, before alternative resolution financing arrangements can be accessed?

2.56 The BRRD requires that, before resolution financing arrangements can be used in order to absorb losses in a firm or contribute to recapitalisation costs, the shareholders and creditors of the firm must bare a loss or contribute to the recapitalisation of at least 8% of the total liabilities of the firm. The consultation proposed that, in the case of a group resolution, the 8% requirement should be interpreted as 8% of the liabilities of the failing bank or banks, or 8% of the liabilities of the holding company – whichever is greater.

2.57 Respondents raised concern with this approach, noting some confusion over where the 8% principle applied to the balance sheet of the holding company or the wider group. The government can confirm that when determining which balance sheet is greater, the requirement is in relation to the balance sheet of the holding company and not the consolidated group balance sheet.

2.58 Respondents also noted that there may be cases where, if losses from the subsidiaries are passed up to the holding company, the losses in the holding company could exceed its original investment in the subsidiary. This may give rise to 'no creditor worse off' claims.

2.59 The government recognises these concerns and notes that the 'no creditor worse off' principle is applied on a per entity basis, and therefore the insolvency counterfactual for HoldCo creditors is the HoldCo entering insolvency at the point directly before a resolution tool is used. This approach therefore may not always cause 'no creditor worse off'.

2.60 The assessment of the 8% requirement shall be made at the point the stabilisation power is exercised. The Treasury will be informed by the Bank of England as to whether they have ensured the 8% contribution has been met through the use of the stabilisation option. Further detail of this, and resolution financing more widely, can be found in the revised code of practice.

Question 18: How should the situation with a bank or investment firm where over 92% of its liabilities at the point of resolution are excluded liabilities to be dealt with. Do you think this is a realistic scenario?

2.61 The consultation proposes that, although an unlikely scenario, there may be case where 92% of a firm's liabilities are excluded from bail-in. In such cases, the consultation considered whether the Bank of England should be obliged to bail-in all liabilities which are not excluded under Article 44 of the BRRD before a contribution from resolution financing arrangements was possible.

2.62 Respondents agreed with the government that this was an unrealistic scenario, but not all together impossible. Respondents generally agreed that bailing in all liabilities that were not excluded under Article 44 was the best approach, but asked for further clarification, possibly from the European Banking Authority (EBA). No provision has been made for this, as the government is of the view this scenario is very unlikely.

Question 19: Do you have any comments on the proposed safeguard for the protected financial arrangements on bail-in?

2.63 The safeguard for protected financial arrangements was consulted on in March 2013. Respondents to that consultation raised concerns that the definition of 'protected liabilities' in that consultation (and accompanying draft order) was not sufficiently broad. In response to that consultation, the government proposed a different approach, where the safeguard will apply to a broad set of liabilities with certain defined exclusions set out in the order.

2.64 In general, respondents were content with this approach. One respondent raised a concern that claims relating to damages may also be secured, therefore making these excluded liabilities. They did note however that this circumstance was likely to be rare.

2.65 The government has noted this concern, but does not believe any additional provision is necessary, as any liability that is an excluded liability under the primary legislation cannot be affected by the secondary order.

Question 20: Do you agree with the proposed approach to implementation of the write down and conversion of capital instruments provision? Do you have any comments on the draft Recovery and Resolution Order?

2.66 In order to ensure that regulatory capital is fully loss absorbing, the BRRD requires that none of the resolution tools are used before regulatory capital has absorbed losses. The BRRD requires that relevant capital instruments are written down or converted and that shares and other instruments of ownership are cancelled. The consultation gave detail on how the government expect this write down to work and also gave its interpretation for the write down in relation to groups.

2.67 In cases where a subsidiary's relevant capital instruments are used to meet the requirements for own funds of both the subsidiary and the wider group, the instruments may be written down when the subsidiary is not failing, but a write down is deemed necessary because otherwise the group will no longer be viable. The consultation proposed that, in these cases, the subsidiary's capital may not be written down to a greater extent or converted on worse terms that equally ranked capital instruments issued by the parent.

2.68 Respondents broadly agreed with the proposed approach. One respondent expressed concern over the treatment of legacy capital instruments. This respondent highlighted that regulatory capital instruments issued before the Capital Requirements Regulation (CRR) (575/2013/EU) came into effect, and do not meet the new requirements for regulatory capital but are recognised as a result of grandfathering provisions in CRR, would not be treated in the same way in resolution as Additional Tier 1 and Tier 2 Capital instruments issued following the coming into effect of the CRR.

2.69 This would effectively mean that these legacy instruments would be preferred over equally ranked instruments that do meet the definitions of the CRR. The Bank Recovery and Resolution Order 2014 therefore ensures that legacy capital instruments which are wholly or partly recognised for regulatory capital purposes are within scope of the mandatory write down and conversion power, by inserting definitions in section 3 of the Banking Act of 'Common Equity Tier 1 instruments', 'Additional Tier 1 instruments' and 'Tier 2 instruments' which include instruments in these classes under the transitional provisions set out in Part 10 of CRR, even though they were issued before CRR came into effect.

Question 21: Do you agree with the government's preliminary view that the 'no shareholder or creditor worse off' provision does not apply in relation to the write down and/or conversion of capital instruments?

2.70 Since the write down and conversion of capital instruments is a mandatory provision at the point of non-viability, and not a discretionary act of the resolution authority, the government expressed a preliminary view that the 'no shareholder or creditor worse off' safeguard should not apply to this write down. The government therefore proposed that the 'no shareholder or creditor worse off' safeguard would not apply to mandatory write-down or conversion. However, the government also noted that this issue was still under discussion at a European level.

2.71 Respondents to this question, in general, agreed with the proposed approach. They did, however, note that this was still an ongoing discussion with the European Commission and that this should only be implemented provided that other member states took the same approach, since otherwise this could leave UK firms at a competitive disadvantage.

2.72 After further consideration, the government decided that the 'no shareholder or creditor worse off' safeguard would apply to all liabilities affected where a write-down occurs alongside a bail-in, in accordance with section 12AA of the Banking Act. However the safeguard will not apply to holders of capital instruments when the write down is applied independently of resolution action. The conversion rate determining the number of shares which may be provided to holders of capital instruments which are written down will be set in accordance with Article 50 of the BRRD, and with guidelines issued by the EBA

Question 22: Do you agree with the proposal not to extend share transfer powers to branches of third country institutions?

2.73 Article 94 of the BRRD requires that member states give resolution authorities powers to support the resolution of a third country institution with a branch or any assets located in the UK.

2.74 The government therefore noted its intention to amend the Banking Act to give the Bank of England the ability to support a resolution action by a home resolution authority by exercising the resolution powers in relation to assets of a third country institution located in the UK or governed by UK law; and rights and liabilities of a third country institution booked through a UK branch or governed by UK law. The government proposed not to give the Bank of England share transfer powers, as branches are very unlikely to have any shares in issuance, making the power ineffective. Respondents agreed with this approach.

Question 23: Do you feel that the Bank of England should have the full set of resolution powers (with the exception of share transfer powers) over branches of third country institution when acting independently to resolve a branch?

2.75 The consultation proposed 2 approaches for powers over third country branches. The first approach was to extend a full set of resolution powers used to support third country branch resolution decisions in the absence of a joint decision and where the Bank of England is acting independently. The second approach was only to extend a limited set of powers to the Bank of England when acting independently. The second option may include a power to require the branch to subsidiarise (which would bring it fully within the scope of the Special Resolution Regime), and enhanced liquidity coverage requirements which could be used to improve the ratio of local assets to local liabilities.

2.76 Respondents agreed that the Bank of England should have powers over third country branches but noted that these should be used as a 'back-stop' and that every effort should be made to coordinate resolution action with the home regulator. Responses were mixed with

some advocating a full set of resolution powers while others thought they should be limited in order to avoid unintended consequences and a disorderly resolution.

2.77 The government is giving further consideration to whether additional powers are needed in relation to branches of foreign institutions operating in the UK.

Question 24: If you do not think the Bank of England should have a full set of resolution powers over branches of third country institutions, what powers do you feel would be appropriate, in order to ensure that the risks posed by these branches can be addressed effectively?

2.78 Respondents that opined on this question agreed with the consultation approach to require branches to subsidiarise, and also noted they would welcome the opportunity to work with the Treasury in ensuring the right balance of these powers was achieved.

Question 25: How should the assets, rights and liabilities of the branch be defined for the purposes of resolving a branch?

2.79 The consultation also sought views on the best approach to define and determine the assets, rights and liabilities relating to a UK branch of a foreign institution. Respondents suggested that the regulatory return of the branch, as proposed to be collected by the PRA in their consultation (CP1/14) would provide the necessary information. One respondent also noted that the assets, rights and liabilities should be defined as those booked through the UK branch as, particularly in relation to financial contracts, many assets, rights a liabilities will be under English law but not held in the UK.

2.80 This issue will be considered further as part of the government's ongoing consideration of the appropriate powers in relation to UK branches of foreign banks.

Question 26: Should the bank levy be used to meet the *ex post* funding requirements and replace the initial contribution for the bank levy in the event they are used. Or should these be repaid by established resolution financing arrangements which follow the Delegated Act on contributions to the resolution financing arrangements?

2.81 The BRRD requires that member states establish resolution financing arrangements for the purpose of ensuring the effective application of the resolution tools and powers. The government is of the view that the existing bank levy (Schedule 19 to the Finance Act 2011) meets these conditions. The consultation noted that, given the 8% requirement, it is unlikely that resolution financing arrangements will be used to absorb losses. The consultation also noted that it was difficult to assess the impact of a financing model under the Delegated Act since its form was not final.

2.82 Respondents were generally in favour of using the bank levy to meet *ex ante* funding requirements, as this avoided the need for an additional burden to be placed on industry and, given the bank levy is already in place, may be operationally easier to implement. However the majority of responds said they were unable to take a view on the requirements for *ex post* funding, as the design of the Delegated Act had not been finalised.

2.83 Now that the Delegated Act has been finalised[3], the government will give this issue further consideration.

[3]Which can be found at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.011.01.0044.01.ENG

Question 27: Should the contribution of the deposit guarantee scheme be capped at 50% of the target level of the deposit guarantee scheme, or at a higher level?

2.84 Article 109 of the BRRD requires the use of the Deposit Guarantee Scheme (DGS) funds to contribute to the cost of resolution, provided the resolution ensures the continuity of access to deposits. This contribution is capped at the losses the DGS would bear under normal insolvency proceedings. When the bail-in tool is applied, the cap is equal to the losses that deposits covered by the DGS would have been exposed to had they been within scope of the bail-in tool.

2.85 Article 109(5) of the BRRD also introduced a cap of a different nature, stating that the contribution should not exceed 50% of the target level of the DGS (as specified under Article 10(2) of the recast Deposit Guarantee Scheme Directive), generally equal to 0.8% of covered deposits.

2.86 Respondents felt that the 50% cap was appropriate and did not think there was a need for it to be higher. The government has decided not introduced a cap meaning that the de facto cap is 100% of the available financial means of the deposit guarantee scheme. Since the *ex ante* funding requirements of both the Financial Services Compensation Scheme (FSCS) and the resolution financing arrangements are met through the bank levy, there seems to be little reason for setting a level below 100%. In practice, it is likely that the insolvency counterfactual will be the limiting factor that determines the maximum contribution of the FSCS, since following the introduction of depositor preference, the FSCS's losses in insolvency would be likely to be extremely small.

Question 28: Do you agree that floating charges should rank after secondary preferential debts on insolvency? If not, what characteristics do floating charges have which make them suitable to benefit from higher protection?

2.87 The consultation set out the proposed changes to the creditor hierarchy in order to meet the depositor preference requirement set out in the BRRD. The BRRD sets out the requirements of where deposits should sit in relation to unsecured creditors. However it does not prescribe where floating charges should sit in relation to deposits. The government proposed that floating charges should be subordinated to both the tiers of deposit protection. This was in line with the Independent Commission on Banking's recommendation.

2.88 Responses to this question were mixed. Those who agreed noted that floating charges were more complex forms of liabilities and generally used by sophisticated investors, therefore benefiting from the second tier of preference was not appropriate.

2.89 Respondents outlined that there are generally 2 types of floating charges; i) those created over the whole or substantially most of the assets in commercial borrowing and ii) those given as additional support to collateral arrangements over certain pools of assets (such as 'system' and 'market' charges (e.g. transactions through CCPs and payment systems).

2.90 Some type ii) floating charges would come under the scope of the Settlement Finality Directive and the Financial Collateral Arrangements Directive, and would therefore benefit from specific protection in normal insolvency proceedings. However this would not be the case for all floating charges and respondents noted that these are used for liquidity purposes and, by subordinating them to eligible deposits, would erode their value considerably.

2.91 The government recognises the concerns raised. However, there does not appear to be sufficient scope under the BRRD to change insolvency law other than specifically in relation to deposits. Therefore, the government has proceeded with the approach set out in the consultation.

Question 29: Are you aware of any pre-1997 corporate shareholding member accounts of a building society?

2.92 Depositor preference in the BRRD ensures that depositors with banks and building societies receive the same level of protection. However there may be some building society members who are not in scope of FSCS protection. Prior to the Building Societies Act 1997, it was possible for large corporates to be a member of a building society. These deposits would not benefit from depositor preference under the BRRD. The government is of the belief that there are a very small number, if any, of this type of account that exist.

2.93 Respondents to this question agreed with the government's belief that there were likely to be very few of these types of accounts held in building societies, and that the small number that existed make up a negligible proportion of their total deposit base. The government's views on this are described in further detail below.

Question 30: Should the powers under section 90B of the Building Societies Act 1985 be exercised so that any existing accounts which will not benefit from deposits preference rank pari passu with unsecured creditors?

2.94 The government proposed to enact the powers under section 90B of the Building Societies Act 1986 to ensure that all building society members were at least treated pari passu to unsecured creditors.

2.95 Respondents to this question agreed that it would be beneficial to enact this legislation in order to ensure all building society members were at least treated pari passu to unsecured creditors. The government can confirm that the powers under section 90B of the Building Societies Act 1986 have been exercised. Therefore, the shares of all members of a building society who do not benefit from depositor preference will be treated pari passu with ordinary unsecured creditors.

3 Conclusion

3.1 The government, by way of the statutory instruments noted in chapter 1 and the revisions to the Banking Act code of practice, has now transposed the requirements of the BRRD into UK law.

3.2 As noted above, the government is giving further thought a number of provisions in the BRRD and whether any further provision is needed to give investors and market participants' greater clarity on the policy approach.

3.3 The government would like to thank all respondents for their views and comments.

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