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Brexit: Recognition of Resolution Actions

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1. Executive Summary

1.1 This paper considers the implications of the UK's withdrawal from the European Union on the continued eligibility of English law governed capital and debt instruments issued by EU27 banks to meet loss-absorbing capacity requirements.

1.2 Both the European Banking Authority (the **EBA**) and the Single Resolution Board (the **SRB**) have expressed concerns that English law governed debt securities might not be eligible to meet the minimum requirement for own funds and eligible liabilities (**MREL**) post-Brexit, on grounds that the application of resolution tools by the relevant resolution authority may not be effective and enforceable.

1.3 A related, but separate, concern relates to the application of the requirements for contractual recognition of bail-in to English law governed contracts that govern existing pre-Brexit liabilities, given that English law will, post-Brexit, be the law of a third country.

1.4 It is clearly important to ensure that there is sufficient confidence in the recognition of resolution actions with respect to loss absorbing instruments and other liabilities governed by English law. This paper considers the potential implications of the UK's withdrawal from the EU, for the purposes of the Bank Recovery and Resolution Directive (**BRRD**)[1] and the BRRD II[2] proposals and concludes that EU27 resolution authorities can be confident that their resolution actions would be recognised as a matter of UK law.

1.5 The UK has an existing statutory framework for the recognition of "third country" resolution actions, which is aligned to that provided for in BRRD. In the event of a no-deal Brexit, the UK approach will be to align the UK resolution policy in respect of EU27 resolution action to the UK approach in respect of third country resolution action. This will mean that post-Brexit EU27 resolution actions will be recognised in the UK, unless doing so is contrary to one or more UK statutory safeguards.[3] With the application of this statutory framework in mind, we consider that:

(a) the inclusion of a Contractual Recognition of Bail-in Clause (defined in paragraph 2.1 below) in <u>new</u> English law governed issuances by EU27 banks should be effective to meet the EBA's and SRB's concerns in respect of the eligibility of English law governed debt securities as MREL post-Brexit;

(b) <u>existing</u> English law governed MREL issued by EU27 banks should continue to meet the conditions for MREL post-Brexit (even where the terms of the instrument do not include a Contractual Recognition of Bail-in Clause) because English law would recognise resolution action taken by EU27 authorities. This is because:

(i) both the UK and EU27 resolution regimes have implemented the BRRD[4] as well as the Financial Stability Board's (**FSB**) Key Attributes of Effective Resolution Regimes for Financial Institutions (the **Key Attributes**). This means that the EU resolution regime provides for resolution powers and objectives which are today largely identical – both in substance and outcomes – with the UK regime; and

(ii) there are no foreseeable grounds for refusing to recognise EU27 resolution action taken in accordance with the BRRD, including as it may be amended by BRRD II. Accordingly, EU27 institutions will be able to demonstrate that any decision of an EU27 resolution authority to write down or convert such debt securities post-Brexit would be effective under English law. The governing law will thus not constitute grounds on

[1] Directive 2014/59/EU.
[2] The BRRD is currently the subject of an EU proposal for amendment and update (the so-called **BRRD II** proposal).
[3] See the HM Treasury's The Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018: explanatory information published 8 October 2018, section entitled "Aligning UK legislation's treatment of EEA states with that for third countries".
[4] Although, as of December 2016, ISDA reported that certain aspects of the BRRD were still to be implemented in France, Latvia and Croatia. See: https://www.isda.org/a/YGiDE/icm-24590303-v6-isda-brrd-implementation-monitor-5th-edition.pdf.

which such debt securities would fall foul of any requirement for assurances that an EU27 resolution action would be recognised;

(c) the above position (set out in (a) and (b)) will equally apply to the application of the Article 55 Requirement to English law contracts giving rise to in-scope liabilities such that the absence of a Contractual Recognition of Bail-in Clause in existing contracts should not adversely affect resolvability.

1.6 It is essential that there is clarity for firms and the market that new and existing English law governed instruments including a Contractual Recognition of Bail-in Clause will be eligible for MREL. This would be consistent with the FSB Key Attributes and Principles for Cross-border Effectiveness of Resolution Actions[5] and ensure that EU27 banks continue to be able to increase their loss absorbing capacity through global markets.

1.7 It is also important for the SRB and other resolution authorities to clarify their approach to existing issuances governed by English law which do not include a Contractual Recognition of Bail-in Clause. As discussed in this paper, we consider that English law would continue to recognise an EU resolution action post-Brexit even in the absence of a Contractual Recognition of Bail-in Clause. This should provide sufficient comfort to enable resolution authorities to take a pragmatic approach to such existing liabilities.

1.8 Finally, clarity is required on the approach to new and existing contracts in the context of the Article 55 Requirement. The analysis set out in this paper in relation to the recognition of EU27 resolution action under English law post-Brexit is equally applicable to the determination of an EU27 resolution authority that relevant liabilities can be subject to the bail-in powers of the EU27 resolution authority under English law (or pursuant to a binding agreement with UK resolution authorities) and therefore that the Article 55 Requirement should not apply – as further detailed in the Article 55 Requirement RTS. [6]

1.9 It will also be important for the market to have confirmation from EU27 resolution authorities that the Article 55 Requirement does not apply to English law contracts entered into pre-Brexit unless there is material amendment to such contracts post-Brexit. However, to the extent that resolution authorities apply the Article 55 Requirement to existing contracts of EU27 banks governed by English law and/or existing contracts of UK banks governed by the law of an EU27 Member State, a phased approach to application would be necessary to allow banks adequate opportunity to comply with the requirement, particularly in the absence of a transition period. In the UK, the UK Prudential Regulation Authority has recognised such concerns and has proposed that the UK contractual recognition of bail-in requirement will not apply in respect of EEA law governed liabilities that were created before the day the UK exits the EU unless they are subject to material amendment on or after the day the UK exits the EU.[7]

[5] http://www.fsb.org/2015/11/principles-for-cross-border-effectiveness-of-resolution-actions/.
[6] See Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (the **Article 55 Requirement RTS**), Article 43(3).
[7] See the UK Prudential Regulation Authority in its Consultation Paper CP26/18 UK withdrawal from the EU: Changes to PRA Rulebook and onshored Binding Technical Standards, October 2018 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp2618-complete paragraph 4.6 and Annex O of CP26/18.

2. Background

2.1 The BRRD establishes a common framework for the recovery and resolution of financial institutions across the EU and, amongst other things:

(a) introduces the requirement for MREL. MREL is designed to absorb losses in a resolution of an in-scope institution with the objective of continuity of critical functions and an orderly wind-down or restructuring of the relevant institution; and

(b) absent a statutory recognition of third country law and subject to the availability of any exclusions, requires in-scope institutions to include a contractual clause recognising that the instrument may be subject to the write-down and conversion powers (i.e. **bail-in powers**) of relevant EU resolution authorities (a **Contractual Recognition of Bail-in Clause**) in contracts governed by non-EU law that: (a) give rise to a liability of the in-scope entity on or after 1 January 2016; or (b) govern a liability of the in-scope entity which is materially amended on or after 1 January 2016 (the **Article 55 Requirement**).

2.2 It has been reported that EU27 banks have issued €126 billion in Additional Tier 1 and Tier 2 capital instruments under English law that may be impacted, in addition to the large amount of English law governed senior non-preferred debt also in issuance and which would otherwise be eligible to meet MREL requirements. If instruments currently eligible for MREL were determined to be ineligible post-Brexit, this would significantly reduce the levels of EU27 banks' eligible instruments and such instruments would either have to be amended or re-issued, potentially causing market disruption.

2.3 The volume of MREL issued under third country law (in particular New York law and, post-Brexit, English law) reflects the demands of market participants and the depth of international investment markets. It is important for EU27 banks to maintain access to these global markets in order to efficiently increase their loss absorbing capacity.

2.4 The EBA has indicated[8] that once the UK leaves the EU English law instruments will become instruments issued under non-EU (so-called **third country**) law (in the absence of an agreement to the contrary) and that the resolution authority will need to engage with EU27 banks as to the means by which they expect legal certainty of existing and new issuances of English law governed instruments to be demonstrated.

2.5 In our paper *Brexit: Key cliff edge risks in wholesale financial services* dated January 2018, we outlined AFME members' concern about the potential 'cliff edge'[9] risks that Brexit can create for market efficiency and financial stability. In particular, we highlighted uncertainty regarding the continued eligibility of English law governed capital and debt instruments issued by EU27 banks to meet loss-absorbing capacity requirements (and instruments issued by UK based banks under EU27 law) as a key risk.[10] If these instruments are determined to be ineligible, this could significantly reduce the levels of eligible instruments, requiring existing instruments to be amended or the issuance of new eligible debt, potentially causing market disruption.

2.6 There is general market concern that if English law (or, indeed, any other third country law) cannot be applied to future MREL issuances of EU27 banks, it would:

(a) reduce the pool of potential investors; and

(b) increase concentration of TLAC / MREL holdings of a resolution entity (and therefore possibility of contagion).

[8] See the EBA's opinion on issues related to the departure of the United Kingdom from the European Union dated 12 October 2017 (the **EBA October 2017 Opinion**), Part IV and footnote 32, and the EBA's opinion on preparations for the withdrawal of the United Kingdom from the European Union dated 25 June 2018 (the **EBA June 2018 Opinion**) paragraphs 11 (j), (k) and (l).

[9] The paper used the following definition of "cliff edge risk": A cliff edge risk is an issue that is expected to create (market) disruption or material impediments to business activities on the day of Brexit if no legislative or regulatory intervention is undertaken.

[10] See also EBA Opinion, 12 October 2017.

2.7 The ability of an EU27 bank to issue debt (including debt which constitutes MREL) under third country law is commercially critical. In particular, such diversified funding:

(a) supports EU27 banks in running efficient and prudent funding models;

(b) supports local liquidity and term-funding requirements and avoid cross-currency risk. Exposures of EU27 banks outside the EU27 are predominantly denominated in USD, and some non-EU27 investors are more accustomed to specific legal order and currency denomination (for example, certain Asian jurisdictions have a preference for English law and USD denominated issuances);

(c) helps ensure effective risk management; and

(d) support the resilience and financial stability of EU27 banks. Third country governed issuances help avoid pro-cyclicality or volatility in specific markets and address a wider pool of willing investors.

Moreover, allowing EU27 to continue to apply existing issuances towards their MREL requirements will ensure legal certainty and clarity to support bank capital and resolution planning. Any perception of "moving-goalposts" risks unsettling investors and unjustifiably increasing the funding costs of EU27 banks which would in turn make it more difficult for EU27 banks to efficiently issue new bail-inable instruments.

2.8 Certainty on whether: (a) existing English law governed debt securities, and (b) new issuances of English law governed debt securities, continue to meet the conditions for recognition as MREL following Brexit is therefore key for market participants.

2.9 Similar considerations, and the need for certainty, arise more broadly in connection with the application of the Article 55 Requirement to existing English law contracts giving rise to in-scope liabilities.

3. Analysis

BRRD and MREL

3.1 The BRRD and the Single Resolution Mechanism Regulation[11] (**SRMR**) set out requirements for in-scope financial intuitions to hold MREL, as determined by their relevant resolution authority, to absorb losses and recapitalise the institution, or their successors, in a resolution scenario with the objective of continuity of critical functions and an orderly wind-down or restructuring of the financial institution.

3.2 Currently, the BRRD (which amended the Credit Institutions Winding Up Directive (**CIWUD**)) provides for the automatic recognition of resolution actions throughout the EU.[12] CIWUD provides for the mutual recognition and enforcement in all EU member states of decisions regarding the reorganisation or winding up of institutions with branches in member states. Under CIWUD, all assets and liabilities of the institution are dealt with in a single process in the home member state and creditors in the host member state are treated in the same way as creditors in the home member state. Absent an intergovernmental agreement for the mutual recognition of resolution actions, such automatic recognition would no longer apply as between the UK and EU27 following Brexit, although we expect that close cooperation between resolution authorities would continue. An end to automatic recognition creates issues for financial institutions, including uncertainty regarding the continued eligibility of English law governed MREL.

3.3 Eligible liabilities may be included in the MREL calculation where they satisfy certain conditions. Where a liability is governed by third country law, the SRB may instruct the relevant resolution authorities to require in-scope institutions to demonstrate that any decision to write-down or convert (bail-in) that liability would be effected under the third country law – having regard to the terms of the contract governing the liability, international agreements on the recognition of resolution proceedings and other relevant matters.[13] Resolution authorities, in turn, may require in-scope institutions to demonstrate that any decision to write-down or convert (i.e. bail-in) that liability would be effective under the third country law – having regard to the terms of the contract governing the liability, international agreements on the recognition of resolution proceedings and other relevant matters.[14] The key factor to be able to demonstrate is that the decision to bail-in the liability would be recognised and enforceable under the third country law.

The Article 55 Requirement

3.4 Brexit also raises similar questions in the context of the application of the Article 55 Requirement: will existing liabilities governed by English law require amendment to include Contractual Recognition of Bail-in Clauses? Absent a statutory recognition of third country law and subject to the availability of any exclusions, the BRRD requires in-scope institutions to include a Contractual Recognition of Bail-in Clause in contracts subject to the Article 55 Requirement. In the context of Brexit, the market requires confirmation from EU27 resolution authorities that the Article 55 Requirement does not apply to English law contracts entered into pre-Brexit, at least unless there is material amendment to such contracts post-Brexit.

3.5 The Article 55 Requirement does not apply where the resolution authority of a Member State determines that the relevant liabilities can be subject to write down and conversion powers by the resolution authority of a Member State pursuant to the law of the third country or to a binding agreement concluded with that third country. The Article 55 Requirement RTS provides further detail on this.[15] In the absence of any binding agreement between a Member State and the UK, resolution

[11] Regulation 806/2014/EU.
[12] See article 66 and 117 of the BRRD.
[13] See article 12(17) of the SRMR
[14] See article 45(5) of the BRRD.

[15] The Article 55 Requirement RTS states that:

authorities will need to assess whether the relevant liabilities governed by English law can be subject to write down and conversion pursuant to English law. In our view the analysis set out in this paper should provide EU27 resolution authorities with the necessary comfort in order to make such determinations.

3.6 The Article 55 Requirement has very broad application as the term "liabilities" is undefined under the BRRD and is generally construed very broadly by EU27 member states when implementing the Article 55 Requirement. In anticipation of Brexit, a number of EU27 banks have included Contractual Recognition of Bail-in Clauses in English law terms governing new MREL issuances or in such terms which govern debt programmes.

3.7 The analysis set out in this paper regarding the application of the Article 55 Requirement to MREL is broadly applicable to the broader sub-set of liabilities also within scope of the Article 55 Requirement.[16] This should be the case regardless of the approach EU27 banks have taken in anticipation of Brexit.[17] However, whilst it is clear that under BRRD II existing English law instruments will need to include the Contractual Recognition of Bail-in Clause in order to be eligible as MREL, it is less clear that contracts giving rise to in-scope liabilities which were entered into pre-Brexit will need to be amended post-Brexit. If EU27 banks were required to update all contracts governed by English law that (a) give rise to a liability of the in-scope entity on or after 1 January 2016; or (b) govern a liability of the in-scope entity which is materially amended on or after 1 January 2016 – this would be an onerous and challenging task. As highlighted in AFME's June 2017 paper *Article 55 of the BRRD: Why it matters and why changes are needed*,[18] implementation – particularly in respect of existing liabilities – is extremely challenging.

3.8 Clarity on the approach to existing contracts in particular in the context of the Article 55 Requirement will crucial for EU27 banks – as such, if the SRB or other resolution authorities were to require the inclusion of Contractual Recognition of Bail-in Clause in contracts entered into before the Brexit date a phased approach to application would be necessary to allow EU27 banks adequate opportunity to comply with the requirement.

BRRD II

3.9 The BRRD II proposal,[19] at the date of this paper, is being considered by the Council of the EU and the European Parliament and the current version of the texts, amongst other things:

(a) propose the deletion of the condition for eligibility of third country law governed MREL which grants the SRB the discretion to instruct resolution authorities to require in-scope institutions (and, in turn, the discretion of resolution authorities to require in-scope institutions) to demonstrate that any decision to bail-in the MREL would be effective under the relevant third country law; and

"a resolution authority shall determine that the requirement to include a contractual term in a relevant agreement shall not apply where it is satisfied that the law of the third country concerned or a binding agreement concluded with that third country provides for an administrative or judicial procedure which:
(a) at the request of the resolution authority, or at the initiative of the third country administrative or judicial authority whose law governs the liability or instrument, enables such duly empowered third country administrative or judicial authority, within a period which the resolution authority determines will not compromise the effective application of the write-down and conversion powers by that authority to do either of the following:
(i) recognise and give effect to the exercise of the write-down and conversion powers by the resolution authority;
(ii) support through the application of relevant powers the exercise of the write-down and conversion powers by the resolution authority;
(b) provides that the grounds on which a third country administrative or judicial authority may refuse to recognise or support the exercise of the write-down and conversion powers pursuant to point (a) are clearly stated and are limited to one or more of the following exceptional cases:
(i) the recognition or support of the exercise of the write-down and conversion powers by the resolution authority would have adverse effects on financial stability in the third country concerned;
(ii) the recognition or support of the exercise of the write-down and conversion powers by the resolution authority would result in third country creditors, in particular depositors located and payable in that third country, being treated less favourably than creditors, and depositors located or payable in the Union, with similar rights under applicable Union law;
(iii) recognition or support would have material financial implications for the third country concerned;
(iv) recognition or support of the exercise of write-down and conversion powers by the resolution authority would have effects contrary to the public order of the third country concerned."

[16] Although we note that there may be nuances to the analysis depending on the type of liability subject to the Article 55 Requirement.
[17] We understand that in anticipation of Brexit, a number of EU27 banks have or are starting to update their English law terms governing liabilities that are in-scope of the Article 55 Requirement so that they include Contractual Recognition of Bail-in Clauses.
[18] See: https://www.afme.eu/globalassets/downloads/briefing-notes/2017/afme-rnn-article-55-paper.pdf.
[19] The BRRD II legislative proposals form part of a package that also amends and updates the SRMR (the so called SRMR II proposal), the Capital Requirements Regulation (EU) No 575/2013 (the so called CRR II proposal) and the Capital Requirements Directive (2013/36/EU) (the so called CRD V proposal).

(b) introduce, as a new subsection to the Article 55 Requirement, a new condition for the eligibility of third country law governed MREL. In short, the new condition as set out under the three proposals for MREL governed by a third country law prescribes that liabilities within scope of the Article 55 Requirement will only be eligible as MREL where a Contractual Recognition of Bail-in Clause has been included in the relevant contract (subject to possible exclusions depending on the final text of the BRRD II),[20] unless the resolution authority determines *ex ante* that the liabilities can be converted or written down pursuant to the law or a binding agreement.[21] The conditions for MREL under the BRRD II proposal cross refer to provisions under the CRR II proposal, which include[22] a requirement for contractual recognition of bail-in in respect of the principal amount of the liabilities to be written down – it appears that such condition is intended to apply regardless of any exclusions available to the Article 55 Requirement.

3.10 In the following sections of this paper, with this background in mind, we consider under the BRRD and the BRRD II proposal the eligibility post-Brexit of English law governed debt issued by an EU27 institution as MREL:

(a) that is already in issuance and: (i) does not include a Contractual Recognition of Bail-in Clause, or (ii) has been updated to include a Contractual Recognition of Bail-in Clause; or

(b) that is newly issued.

This analysis proceeds on the assumption that no statutory recognition of EU crisis prevention measures or crisis management measures is adopted in the UK.

(A) Existing English law governed MREL: BRRD analysis

(i) Existing English law governed contracts with a Contractual Recognition of Bail-in Clause

3.11 A number of EU27 banks have started to include a Contractual Recognition of Bail-in Clause in new English law governed terms or in revisions to programme documentation to ensure that they meet the Article 55 Requirement, post-Brexit.

3.12 As noted above, in-scope EU27 institutions may be required to demonstrate that any decision to write-down or convert (bail-in) liabilities which constitute MREL would be effective under the third country law having regard, amongst other things, to the terms of the contract governing the liability.

3.13 In addition to the arguments set out below (see paragraph 3.20) in relation to the UK authorities' recognition of EU27 resolution proceedings (and therefore that EU27 banks should be able to demonstrate that English law governed MREL continues to be eligible), such entities will also be able to demonstrate that the terms of the contract governing the liability explicitly recognise an EU27 resolution authority's exercise of bail-in powers. This should put such entities in an even more robust position to meet the conditions for eligibility as MREL.

3.14 Brexit should not affect the enforceability of a Contractual Recognition of Bail-in Clause as a matter of English law; we see no public policy or other reason for an English court not to uphold the contractual choice to recognise and be bound by the bail-in action of an EU27 resolution authority taken in accordance with the BRRD. Post-Brexit we would expect that legal opinions as to the effectiveness and enforceability of a Contractual Recognition of Bail-in Clause will continue to be available on substantially identical terms to today.

[20] The proposed text for this new condition varies between the proposals as set out by the EU Commission, EU Council and EU Parliament, the:
(i) EU Commission initial proposal condition states that liabilities that are able to rely on the new "impracticability" exclusion or that are granted a waiver by the relevant resolution authority to the Article 55 Requirement shall not be counted towards MREL.
(ii) EU Council position (23 May 2018) condition states that liabilities that do not include a Contractual Recognition of Bail-in Clause in accordance with the Article 55 Requirement shall not be counted towards MREL.
(iii) EU Parliament position (25 June 2018) condition states that liabilities that do not include a Contractual Recognition of Bail-in Clause in accordance with the Article 55 Requirement (even in circumstances where an in-scope entity is able to rely on the "impracticability" exclusion) shall not be counted towards MREL.

[21] The Article 55 Requirement RTS should remain applicable to any such determination or legal binding agreement between resolution authorities under the BRRD II proposal – although there are drafting difference between the various texts as discussed in footnote 18 above.

[22] See Article 72b(2)(o) of the EU Commission's initial proposal.

(ii) Existing English law governed instruments without a Contractual Recognition of Bail-in Clause

3.15 EU27 resolution authorities should be satisfied that any decision to write down or convert existing English law governed MREL that does not include a Contractual Recognition of Bail-in Clause would be effective under English law post-Brexit and therefore should continue to be eligible as MREL under the BRRD. This is because there is no foreseeable basis for refusing recognition of the use of bail-in powers by EU resolution authorities.

3.16 Post-Brexit, the UK intends to default to treating EU Member States largely as it does other third countries[23] and therefore the approach to third country resolution action under the UK bank resolution regime will be relevant to EU27 banks post-Brexit.

3.17 The UK bank resolution regime under part 1, chapter 6 of the Banking Act 2009 contemplates circumstances in which resolution action is initiated against a third country institution in a third country and requires that the Bank of England recognise the resolution proceedings of a third country institution where:

(a) the results and objectives of the UK regime and the resolution regime of the third country are broadly comparable; unless

(b) the third country resolution action gives rise to one or more of the UK statutory grounds for refusal.

3.18 The first condition of "***comparability***" should be met with ease: both the UK and national EU27 regimes implement the BRRD as well as the Financial Stability Board (**FSB**) Key Attributes of Effective Resolution Regimes for Financial Institutions (the **Key Attributes**). This means that current EU resolution regimes provide for resolution powers and objectives which are today largely identical – both in substance and outcomes – with the UK regime.

3.19 The second condition of "***grounds for refusal***" requires a fact specific analysis. The Bank of England may only refuse to recognise a third country resolution action, in whole or in part, where both the Bank of England and HM Treasury are satisfied that that one or more of the following conditions are satisfied:

(a) recognition would have an adverse effect on financial stability in the UK;[24]

(b) the taking of [separate] action in relation to the branch located in the UK is necessary to achieve one or more of the UK special resolution objectives;[25]

(c) under the third country resolution action creditors (including, in particular, depositors) located in the UK[26] would not receive the same treatment as creditors (including depositors) who are located in the third country concerned and have similar legal rights;

(d) recognition of, and taking action in support of, the third country resolution action would have material fiscal implications for the UK; or

(e) recognition would be unlawful under section 6 of the Human Rights Act 1998 (which provides that a public authority must not act contrary to the Human Rights Convention).[27]

[23] See HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act, paragraph 1.18 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/720298/HM_Treasury_s_approach_to_financial_services_legislation_under_the_European_Union__Withdrawal__Act.pdf, the draft Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018 https://www.gov.uk/government/publications/draft-bank-recovery-and-resolution-and-miscellaneous-provisions-amendment-eu-exit-regulations-2018 and explanatory information referenced in footnote 3 above.

[24] We expect the reference to "or another EEA member state" to be removed from this limb post-Brexit.

[25] As set out in section 4 of the Banking Act 2009. When exercising powers in respect of a third country institution, in addition to the seven specified objectives, the UK authorities must have regard to an additional objective 8: "…*to support third-country resolution action with a view to promoting objectives which, in relation to the third country concerned, correspond to Objectives 1 to 7 in relation to the United Kingdom*".

[26] We expect the reference to "an EEA state" to be removed from this limb post-Brexit.

[27] We expect the reference to "or contrary to a provision of EU law" to be removed from this limb post-Brexit.

The grounds for refusal implement article 95 of the BRRD and are therefore in very similar terms to the grounds on which an EU27 resolution authority may refuse to recognise a third country resolution action. Whilst more detailed, such grounds are not inconsistent with those provided for the in the FSB's Key Attributes.

3.20 In all foreseeable circumstances we see no grounds for refusal and we would make the following observations, with respect to:

(a) ground (a), *adverse effect on the financial stability of the UK*: a refusal by the Bank of England or HM Treasury to recognise EU27 resolution action would result in an uncoordinated resolution of the EU27 entity which, contrary to the UK resolution conditions, would certainly have an adverse effect on the financial stability of the UK. Coordinated UK/EU27 resolution action is in the interests of the EU27 and UK authorities as it minimises market disruption;

(b) ground (b), *achieving UK special resolution objectives*: the UK's resolution objectives are consistent with those of the EU27 and both the UK and EU27 authorities should be members of the relevant EU27 institution's crisis management college which would ensure the resolution of objectives of both the EU27 and UK are taken into account – this would avoid the need for separate UK action being taken in relation to the branch located in the UK to achieve one or more of the UK special resolution objectives;

(c) ground (c), *unequal treatment*: an EU27 member state treatment of EU27/UK MREL creditors (who are senior non-preferred creditors) in resolution would not be unequal. The amendment to the creditor hierarchy for certain deposits under article 108 of the BRRD – such that EU27 depositors would be preferred over third country depositors, including UK depositors post-Brexit, in resolution scenario - does not affect the equality of treatment of creditors for the purposes of MREL. Holders of MREL (whether EU27 or third country creditors) should not be considered depositors and therefore article 108 should not provide any basis for preferring EU holders of MREL over third country holders of MREL. Unequal treatment of EU27 and UK MREL creditors is not permissible under the BRRD therefore would not provide a ground for refusal;

(d) ground (d), *material fiscal implications for the UK*: absent a supportive approach to the resolution of an EU27 entity by UK resolution authorities, the UK would likely suffer material fiscal consequences and would provide a further reason for UK authorities to support EU27 resolution action, rather than a ground for refusal; and

(e) ground (e), *unlawfulness*: nothing in EU legislation inherently conflicts with the Human Rights Act on the basis that each EU member state's statutory regime should have an analogous framework that requires that a public authority must not act contrary to the Human Rights Convention.

3.21 In addition to the reasons outlined above, the policy of the UK authorities to date also strongly indicates that a supportive approach would be taken by the UK authorities.

3.22 As already noted, both the UK and EU27 member states have implemented the BRRD and are signatories of the FSB's Key Attributes and we would expect both the UK and EU27 authorities to be members of the relevant EU27 bank's crisis management college. The FSB's Key Attributes provide "*a new international standard for resolution regimes*" and set out 12 "*key attributes*", including "*a legal framework for conditions for cross-border cooperation*" which aims to "*facilitate the coordinated resolution of firms active in multiple countries*".

3.23 The Bank of England's *Approach to Resolution document and HM Treasury's Banking Act 2009: Special Resolution Regime Code of Practice* (the **Code of Practice**) explicitly supports the FSB's aims for effective and consistent approaches to resolution proceedings across different jurisdictions. The Code of Practice notes that the UK authorities are "*…strongly encouraged to achieve a cooperative solution, helping to ensure third country resolution is successful*". This background provides a policy basis for

the legal conclusion that recognition and/or supporting resolution proceedings would likely be undertaken by the UK authorities in respect of EU27 resolution action.

(B) Existing English law governed MREL: BRRD II analysis

3.24 As set out at paragraph 3.9 above, the new condition under the BRRD II proposal for MREL governed by a third country law, in general terms, prescribes that liabilities within scope of the Article 55 Requirement (subject to possible exclusions depending on the final text of the BRRD II) will only be eligible as MREL where a Contractual Recognition of Bail-in Clause has been included in the relevant contract.

3.25 If the BRRD II proposals are implemented in their current form this would mean that English law governed MREL issued by EU27 banks on or after 1 January 2016 must include a Contractual Recognition of Bail-in Clause (subject to possible exclusions). As such, our analysis above as to the enforceability of the Contractual Recognition of Bail-in Requirement will equally apply.

(C) New English law governed MREL: BRRD analysis

3.26 Post-Brexit new English law governed debt that constitutes MREL would fall within the Article 55 Requirement and therefore should include a Contractual Recognition of Bail-in Clause. Legal opinions supporting the enforceability of Contractual Recognition of Bail-in Clauses in English law governed MREL and the English courts will give high degree of certainty on the effectiveness of Contractual Recognition of Bail-in Clauses but may appear to not be definitive because of the lack of case law and the fact specific nature of the refusal conditions. We do not consider this to undermine the impact of such opinions in any meaningful way. The business-friendly nature of English law is a large part of the reason for the large volumes of MREL currently issued under English law. It is also worth noting that third country governed MREL existing today and post-Brexit any English law opinion would be no less strong than an opinion received currently for non-EU law governed MREL. We expect the inclusion of a Contractual Recognition of Bail-in Clause in new English law governed issuances by EU27 banks should be effective to meet the EBA's concerns and satisfy the SRB and national resolution authorities in respect of the eligibility of English law governed debt securities as MREL post-Brexit.

3.27 The analysis for this category of instruments should therefore follow that set out above in relation to *Existing English law governed contracts with a Contractual Recognition of Bail-in Clause* under paragraphs 3.11 to 3.14.

(D) New English law governed MREL: BRRD II analysis

3.28 As set out in relation to *New English law governed instruments: BRRD analysis*, post-Brexit new English law governed debt that constitutes MREL would fall within the Article 55 Requirement and therefore should include a Contractual Recognition of Bail-in Clause. The analysis for this category of instruments should therefore follow that set out above in relation to *Existing English law governed contracts with a Contractual Recognition of Bail-in Clause* under paragraphs 3.11 to 3.14.

4. Clarity Required

4.1 It is essential that there is clarity for firms and the market that new and existing English law governed instruments including a Contractual Recognition of Bail-in Clause will be eligible for MREL. This would be consistent with the FSB Key Attributes and Principles for Cross-border Effectiveness of Resolution Actions and ensure that EU27 banks continue to be able to increase their loss absorbing capacity through global markets.

4.2 It is also important for the SRB and other resolution authorities to clarify their approach to existing issuances governed by English law which do not include a Contractual Recognition of Bail-in Clause. We see no basis under English law on which recognition of an EU resolution action post-Brexit might be refused, even in the absence of a Contractual Recognition of Bail-in Clause. This should provide sufficient comfort to enable resolution authorities to take a pragmatic approach to such existing liabilities.

4.3 Clarity is also required on the approach to new and existing contracts in the context of the Article 55 Requirement. The above analysis in relation to the recognition of EU27 resolution action under English law post-Brexit is equally applicable to the determination of an EU27 resolution authority that relevant liabilities can be subject to the bail-in powers of the EU27 resolution authority under English law (or pursuant to a binding agreement with UK resolution authorities) and therefore that the Article 55 Requirement should not apply – as further detailed in the Article 55 Requirement RTS. In our view the analysis set out in this paper should provide EU27 resolution authorities with the necessary comfort in order to determine that English law liabilities can be subject to the bail-in powers of the EU27 resolution authority under English law.

4.4 However, to the extent that resolution authorities apply the Article 55 Requirement to existing contracts of EU27 banks governed by English law and/or existing contracts of UK firms governed by the law of an EU27 Member State, a phased approach to application would be necessary to allow EU27 banks adequate opportunity to comply with the requirement, particularly in the absence of a transition period.

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