HM Treasury: Transposition of the BRRD2

AFME consultation response 11 August 2020

Introduction

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity to comment on Her Majesty's Treasury's (HMT's) consultation paper regarding the transposition of the Bank Recovery and Resolution Directive 2 (BRRD2) into UK law. We hope that HMT will find our response of assistance when finalising its approach.

AFME continues to support the development of an effective recovery and resolution framework and the ongoing work to enhance resolvability across Europe, including in the UK. We note the legal obligation to transpose the BRRD2 to the extent necessary under the European Union (Withdrawal Agreement) Act 2020 and in general terms we support ongoing consistency of approach under the umbrella of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions to support recovery and resolution planning for cross-border groups. In this context we set out below our comments in response to the consultation paper, taking account of the existing requirements that already apply as part of the UK's resolution framework, specifically where these already meet the objectives, or are similar to, provisions and requirements within BRRD2.

General comments

Whilst we welcome the opportunity to provide our views on the questions raised in the consultation, the consultation paper does not provide any details as to the approach which will be taken. This includes the elements of BRRD2 that have been highlighted, but even more so on the elements that have not been included in the consultation paper.

It is important that firms are provided with an adequate opportunity to review and respond to the proposed regulation and an appropriate period to implement any changes which result. We therefore would welcome a further consultative period on the full draft legislation when available, alongside a clear policy statement on the approach that will be taken by HMT in transposing BRRD2 into UK law, as well as on the future framework that will apply thereafter.

Given AFME's focus on pan-European financial markets, we have focussed our response on those elements that have a particular cross-border impact. We would welcome the opportunity to explore these issues further as and when appropriate.

[1] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

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Moratorium powers

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

As we have highlighted during the original legislative process bringing forward BRRD2, we do not believe that it is necessary to introduce a new pre-resolution moratorium power in order to achieve the objective of an effective recovery and resolution framework. We remain concerned that the introduction of a pre-resolution moratorium power may cause significant concern for counterparties and potentially be counterproductive to the objective of ensuring continuity of critical functions. The very existence of a pre-resolution stay, even if not exercised, could by itself create uncertainty in the market and incentivise counterparties, including uninsured depositors (but also those insured depositors who are unwilling to rely on deposit insurance schemes) to withdraw their funds at an earlier stage than they may otherwise do.

This is also the case with regard to the amendments to the 'in-resolution' moratorium powers, given the extension to also include eligible deposits within their scope. We remain concerned that the application of a moratorium to such liabilities could be contrary to the resolution objectives of ensuring that critical economic functions are uninterrupted. Moratorium tools amended as such (either pre-resolution or in-resolution) could undermine the resolution objectives, make communication to creditors and the market more difficult, and potentially threaten the success of the resolution. We also understand that the main objective of the introduction of the pre-resolution moratorium power under BRRD2 was to bridge a potential gap between a "failing or likely to fail" determination and a decision to place the institution into resolution. In the UK we expect that the prospect of a significant gap between such decisions is likely to be low given the close cooperation between the UK authorities and, therefore, the introduction of the pre-resolution moratorium is likely not to add value in the circumstances applicable to the UK.

We view the existing moratoria (and their scope) under the BRRD, and as transposed into UK law, under Sections 70A – 70D of the Banking Act, pursuant to the Bank Recovery and Resolution Order 2014[2], sufficient. These existing powers enable authorities to conduct an effective resolution and extending these existing powers to include a pre-resolution moratorium would likely be counter-productive as it may increase the level of systemic risk within European financial markets. There is broad recognition and acceptance of the existing powers and their scope, as well as the equivalent stays in other jurisdictions, as they are aligned with the global standards under the FSB Key Attributes of Effective Resolution Regimes, which provide for a limited stay on termination rights in certain circumstances (see Key Attribute 4.3 and I-Annex 5). The BRRD2's change in scope to the existing moratoria, and, the introduction of a new pre-resolution moratorium, go beyond the global standards and do not appear to be necessary at all and for the UK's resolution framework, in particular.

We therefore strongly oppose the introduction of the additional moratoria tool and the change in scope to the already existing and sufficient powers provided for in UK legislation. Considering however the potential legal obligation to transpose BRRD2, we would encourage HMT to consider limiting the application of these changes to that period during which the UK still needs to observe the EU rules and regulations.

[2] The Bank Recovery and Resolution Order 2014: http://www.legislation.gov.uk/uksi/2014/3329/pdfs/uksi_20143329_en.pdf

Contractual recognition of stay powers

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

The UK as a member of the G20 has already implemented requirements for the contractual recognition of stay powers, as recommended by the FSB's "*Principles for Cross-border Effectiveness of Resolution Actions*"[3]. The current rules that apply as per the PRA Rulebook "*CRR firms and non-authorised persons: stay in resolution instrument 2015 (2015/82)*"[4], and similar requirements in other G20 countries, have been the subject of a very significant effort by industry to put in place globally recognised terms that fulfil the need for counterparties to recognise the stay powers that they may be subject to in the event of an in-scope entity entering into a resolution. This includes the implementation of the ISDA 2015 Universal Stay Protocol, the ISDA Stay Modules for specific jurisdictions, including the UK to which approaching 2,400 counterparties currently adhere[5], as well as similarly effective language in Global Master Repurchase Agreements (GMRAs) and Global Master Securities Lending Agreements (GMSLAs).

The UK already has in place a mature and effective requirement for contractual stay recognition for the existing stay powers available which we believe meets the policy objective of ensuring effective cross-border effectiveness of resolution stays. The requirements are also aligned to the scope of those stay powers, as already considered by the PRA in their previous consultation on this issue back in May 2015[6], and as finalised under Supervisory Statement 42/15[7]. In line with our comments on the introduction of the new moratorium tool above, and the change in scope to the existing moratoria, we do not believe further changes are necessary with regard to the existing PRA stay recognition requirements since the UK already has a sufficient and well-functioning solution.

We are concerned that the changes to the scope of existing moratoria tools in the UK, and the introduction of the new moratorium stay power as per Article 33a BRRD2, could create a significant burden on firms including the need to amend existing protocols (e.g. ISDA protocols) and contracts which have already been amended to recognise existing stays. Such further amendments would be overly burdensome (especially in view of the ongoing work on Bank of England's Resolvability Assessment Framework and other, ongoing, regulatory compliance exercises) and could, additionally, create significant confusion in the market in light of the existing stay recognition terms.

To the extent such transposition does take place, we request that the new stay power is transposed as a crisis prevention measure to enable it to be covered by the scope of existing protocols for contractual recognition of stay powers, including, for example, as at present under existing master agreements. We would also highlight that due to a lack of transitional relief under the PRA's temporary transitional power (TTP), UK firms are required to bring new EEA law governed agreements into compliance with PRA Stay rules by end-2020. In the event that repapering is required to comply with any future revisions to PRA Stay rules in the UK's implementation of BRRD2, firms will be required to conduct a separate outreach in 2021 (or whenever the PRA rules are finalised) to obtain client consent to amend those contracts governed by EEA law concluded only a few months earlier. This would expose UK firms to extra costs and repapering efforts, when UK firms are already under heightened operational burden due to preparations for the end of the Brexit transition period. It may also create a negative perception of the UK regulatory framework by international clients. We

[3] FSB – Principles for Cross-border Effectiveness of Resolution Actions – 3 November 2015 - https://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf

[4] PRA Rulebook: CRR firms and non-authorised persons: stay in resolution instrument 2015 (2015/82) - https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2015/ps2515app1.pdf?la=en&hash=5293DCDEBF13E51F536A18C32822B1B155866E32

[5] ISDA UK (PRA Rule) Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol - https://www.isda.org/protocol/isda-uk-pra-rule-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/adhering-parties

[6] PRA Consultation Paper CP19/15 – Contractual stays in financial contracts governed by third-country law, May 2015 - https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2015/cp1915

[7] PRA - Contractual stays in financial contracts governed by third-country law, November 2015 - https://www.bankofengland.co.uk/prudential-regulation/publication/2015/contractual-stays-in-financial-contracts-governed-by-third-country-law

would advocate for the TTP to provide a standstill for in-scope EEA contracts at the end of the transition period until any revision of the PRA Stay rules becomes effective.

Further to this, the European Banking Authority (EBA) is currently consulting on proposed draft Regulatory Technical Standards under Article 71a[8], which unfortunately does not take into consideration the efforts that have already been expended to put in place effective terms for the contractual recognition of stay powers in many jurisdictions including the UK. We have a significant number of concerns with the approach proposed by the EBA, and will share our response to the EBA consultation with HMT once it has been submitted by the EBA's 15 August 2020 deadline.

Contractual recognition of bail-in

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

We welcomed the acknowledgment of the need to amend Article 55 to provide for an impracticability waiver across the EU through changes to the BRRD under the Banking Package. This approach was largely inspired by the one that had been taken forward by the Bank of England and the PRA back in 2016, as per Supervisory Statement SS7/16[9]. The experience that has been developed in the UK since 2016 on this issue has permitted both banks and the authorities to better understand where cases of impracticability arise and has been achieved without the need for burdensome notification requirements. Under the current approach firms can be held to account and challenged by the PRA, which has led to banks putting in place robust processes when it comes to cases of impracticability, which in our view represents a stronger regime of accountability than would be achieved through notification to the relevant authority as under the BRRD2.

Given the approach already in place on the issue of impracticability, which is rational and takes into account the practicalities of the marketplace, we would consider it unnecessary to make changes to UK law in light of the requirement to transpose the amended Article 55. Additionally we are of the view that a transposition of the amendments to Article 55 under the BRRD2, particularly sub paragraph 2, would not result in any benefits for either the UK authorities or individual firms, but may in fact weaken the regime already in place.

Beyond the introduction of a notification requirement, the new Article 55 under BRRD2 also introduces the concept of a trigger for an automatic assessment of a firm's resolvability, where more than 10% of a liability class containing eligible liabilities benefits from the use of the impracticability waiver. We do not believe such automaticity is helpful, as it may negatively impact how firms approach the use of the impracticability waiver whereby the 10% threshold may otherwise be deemed as a cap. This may lead to legitimate use of the waiver being avoided, and in the presence of impracticability, could force firms to avoid entering into contracts that otherwise could benefit from the waiver. This in turn may see business opportunities missed in key areas that are well known to be cases of impracticability (e.g. trade finance).

Given these concerns, we would encourage the UK authorities to reflect upon whether it is necessary to make changes to the current approach when considering transposition of BRRD2.

Further comments

Beyond the aspects of BRRD2 highlighted in the consultation paper, there are other aspects of the directive in relation to which we would welcome clarity, specifically, the UK's approach to transposition and the impact it may have on the existing regime.

[8] EBA – consultation on technical standards for contractual recognition of stay powers under the BRRD - https://eba.europa.eu/eba-consults-technical-standards-contractual-recognition-stay-powers-under-brrd

[9] Bank of England, PRA SS7/16, The contractual recognition of bail-in: impracticability, June 2016 - https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2016/ss716.pdf?la=en&hash=2902017E3A15B4CFFEE957D20C126BA7AFEB1B93

These include changes to Article 59, which largely reflects changes in the write down of internal MREL as defined under Article 45f(2), but where the changes to Article 45 are not, we understand, being transposed; and, Article 48(7), which introduces changes to the hierarchy of claims in insolvency, particularly those stemming from own funds items and the need to effectively 'seniorise' all non-own funds items in respect to these claims.

With respect to Article 48(7), the changes would have a significant potential impact on the treatment of own funds instruments. Article 48(7) mandates changes to national insolvency laws that could have significant implications for the treatment of capital instruments. This has multiple implications, not least given the fact that the sequence of bail-in is specified to follow the prudential classification, which could therefore result in the creation of No-Creditor-Worse-Off risk. Beyond this there are interactions with the eligibility criteria for Additional Tier 1 and Tier 2 instruments (where strict subordination requirements of Articles 52 (1)(d) and 63(d) respectively requires Additional Tier 1 and Tier 2 instruments to rank below Tier 2 and eligible liabilities instruments respectively).

Such changes as required under Article 48(7) to the insolvency hierarchy are extremely complex. There remains a risk that any future changes to the regulations could see the risk profile of securities alter as they come in and out of different prudential capital tiers, ultimately impacting investor confidence in the contractual basis of the securities in which they invest. Additionally, changing the legal ranking of instruments will have an impact on the market price.

Given the importance of this issue we would strongly encourage HMT to not transpose this element of BRRD2 at this time, without ample consideration of the different impacts of the various options that could be taken forward, and a comprehensive consultation with industry. We would also highlight that this is not an area that should be subject to any short-lived transposition, i.e. where changes are repealed after 1 January 2021, given the impact it would have on the pricing of a large number of instruments, even for a short period.

Further to this, we understand that Article 48(7) was inserted into the BRRD2 to deal with issues under certain other EU Member State insolvency laws. It is not clear what policy objective the provision seeks to achieve in the context of UK insolvency law, and we would greatly appreciate clarity from HMT on its approach before considering the transposition of such an impactful change.

Conclusion:

The UK has been in the vanguard of regulatory change and innovation in the areas covered by BRRD2, and the outcome of the UK's existing rules and processes and those that have been put forward by BRRD2 in the areas discussed above tend to have the same policy objective. Nevertheless, while AFME continues to support the development of an effective recovery and resolution framework in the UK and across Europe and as much consistency as possible in approach, in light of the fact that the UK already has a working and well-thought out approach in many areas covered by BRRD2, there are instances where we strongly recommend that HMT considers whether it is necessary to amend some of the existing rules and requirements when transposing BRRD2 and/or with effect from the end of the transition period.

We welcome any questions or views you may have on this response and we are very happy to discuss these issues further.

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