
DRAFT STATUTORY INSTRUMENTS

2014 No.

The Bank Recovery and Resolution Order 2014

Mandatory write-down, conversion, etc of capital instruments

10. After section 6(1) insert—

“Mandatory write-down, conversion etc of capital instruments

Cases where mandatory write-down, conversion, etc applies

6A.—(1) Section 6B applies in relation to a bank in the cases set out in subsections (2) to (6).

(2) Case 1 is where—

- (a) the conditions imposed by sections 7 to 9 on the exercise of a stabilisation power in respect of the bank are met,
- (b) the Bank of England or the Treasury (as the case may be) has decided to exercise the power, and
- (c) section 12AA (mandatory write-down etc in bail-in cases) does not apply.

(3) Case 2 is where—

- (a) the PRA is satisfied that Condition 1 in section 7 is met in respect of the bank, and
- (b) the Bank of England is satisfied that—
 - (i) (ignoring section 6B) Condition 2 in section 7 is met, and
 - (ii) that Condition will continue to be met unless the action required by section 6B is taken in respect of the bank.

(4) Case 3 is where—

- (a) the bank is viable,
- (b) it is a subsidiary,
- (c) relevant capital instruments issued by it are recognised for the purpose of meeting own funds requirements on an individual basis and on a consolidated basis, and
- (d) the appropriate authority of the EEA state in which the consolidating supervisor is situated and the Bank of England make a joint determination in accordance with Article 59.3(c) of the recovery and resolution directive that the group of which the bank is a member will not be viable unless the action required by section 6B is taken in relation to those instruments.

(5) Case 4 is where—

- (a) the bank is a parent undertaking,

- (b) relevant capital instruments issued by the bank are recognised for the purposes of meeting own funds requirements on an individual basis at the level of the parent undertaking or on a consolidated basis, and
 - (c) the Bank of England makes a determination that the group will not be viable unless the action required by section 6B is taken in relation to those instruments.
- (6) Case 5 is where—
- (a) extraordinary public financial support is required by the bank other than in circumstances where subsection (5E)(2) of section 7 applies by virtue of paragraph (c) of that subsection, and
 - (b) the Bank of England is satisfied, on the basis of the valuation carried out in accordance with section 6E(3), that, in order for the bank to fulfil its own funds requirements, relevant capital instruments of the bank need to be written down or converted into Common Equity Tier 1 instruments (or both).
- (7) For the purposes of Case 3, the bank is viable unless—
- (a) the PRA is satisfied that the bank is failing or likely to fail (within the meaning of section 7(5C)), and
 - (b) having regard to timing and other relevant circumstances, the Bank of England is satisfied that it is not reasonably likely that (ignoring section 6B and the stabilisation powers) action will be taken by or in respect of the bank that will result in the bank no longer being a bank which is failing or likely to fail.
- (8) For the purposes of Cases 3 and 4 a group is not viable if (and only if)—
- (a) the consolidating supervisor is satisfied that a requirement under the capital requirements regulation that applies, on a consolidated basis, to a bank which is a member of the group is infringed (or will in the near future be infringed) in a way that justifies action by the consolidating supervisor, and
 - (b) having regard to timing and other relevant circumstances (but ignoring section 6B and the stabilisation powers), it is not reasonably likely that action will be taken by or in respect of the bank that will prevent the requirement being infringed.
- (9) In this section—
- “appropriate authority” means the authority authorised, under the law of the EEA state mentioned in paragraph (d) of subsection (4), to enter into the joint determination mentioned in that paragraph,
- “consolidated basis” has the meaning given by Article 2.1(7) of the recovery and resolution directive,
- “consolidating supervisor” means a consolidating supervisor as defined in Article 4.1(41) of the capital requirements regulation,
- “group” has the meaning given in section 3(2)(b),
- “parent undertaking” has the meaning given by Article 4.1(15)(a) of the capital requirements regulation, and
- “subsidiary” has the meaning given by Article 4.1(16) of the capital requirements regulation.

(2) Substituted, with subsections (1) to (5H), by article 12 of this Order.

(3) Inserted by article 11 of this Order.

Mandatory write-down, conversion, etc of capital instruments

6B.—(1) In a case where this section applies, the Bank of England must without delay make—

- (a) an instrument in relation to the bank containing the mandatory reduction provision, or
- (b) two or more instruments which (taken together) contain that provision.

An instrument made under this subsection is a “mandatory reduction instrument”.

(2) “The mandatory reduction provision” is provision which produces the following results—

- (a) existing Common Equity Tier 1 instruments of the bank are cancelled, transferred or diluted in accordance with the principle that losses should be borne first by the holders of such instruments,
 - (b) the principal amount of Additional Tier 1 instruments of the bank is reduced or such instruments are converted (directly or indirectly) into Common Equity Tier 1 instruments (or both)—
 - (i) to the extent required to achieve the special resolution objectives set out in section 4, or
 - (ii) to the extent of the capacity of the relevant capital instruments, whichever is lower; and
 - (c) the principal amount of Tier 2 instruments is reduced or Tier 2 instruments are converted (directly or indirectly) into Common Equity Tier 1 instruments (or both)—
 - (i) to the extent required to achieve the special resolution objectives set out in section 4 (so far as not achieved under paragraph (b)), or
 - (ii) to the extent of the capacity of the relevant capital instruments, whichever is lower.
- (3) For the purposes of subsection (2), a mandatory reduction instrument may contain—
- (a) provision cancelling existing Common Equity Tier 1 instruments of the bank,
 - (b) provision transferring (directly or indirectly), to holders of Additional Tier 1 instruments or Tier 2 instruments of the bank, Common Equity Tier 1 instruments of the bank,
 - (c) provision converting relevant capital instruments of the bank (directly or indirectly) into Common Equity Tier 1 instruments of the bank or a parent undertaking of the bank,
 - (d) provision cancelling a liability owed by the bank,
 - (e) provision modifying, or changing the form of, a liability owed by the bank,
 - (f) provision that a contract under which the bank has a liability is to have effect as if a specified right had been exercised under it.
- (4) The following rules apply to the interpretation of subsection (3)—
- A. The reference to cancelling a liability owed by the bank includes a reference to cancelling a contract under which the bank has a liability.
 - B. The reference to modifying a liability owed by the bank includes a reference to modifying the terms (or the effect of the terms) of a contract under which the bank has a liability.

C. The reference to changing the form of a liability owed by the bank includes, for example—

- (i) converting an instrument under which the bank owed a liability from one form or class to another,
- (ii) replacing such an instrument with another instrument of a different form or class, or
- (iii) creating a new security (of any form or class) in connection with the modification of such an instrument.

(5) Provision made by virtue of subsection (3) may include—

- (a) provision for securities issued by a specified bank to be transferred to a resolution administrator (see section 62B(4)) or another person;
- (b) where a previous mandatory reduction instrument (“the original instrument”) has contained provision under paragraph (a), provision for the transfer of—
 - (i) securities which were transferred by the original instrument, or
 - (ii) securities which were issued by the bank after the original instrument was made.

(6) Provision made in accordance with subsection (5) may relate to—

- (a) specified securities, or
- (b) securities of a specified description.

(7) Where the Bank of England has exercised the power in subsection (5)(a) to transfer securities to a resolution administrator, the Bank must exercise its functions under this Part with a view to ensuring that any securities held by that person in the capacity of resolution administrator are so held only for so long as is, in the Bank of England’s opinion, appropriate having regard to the special resolution objectives.

(8) Where Case 1 in section 6A applies, the Bank must comply with subsection (1) before or at the same time as exercising the stabilisation power.

(9) Where Case 3 in section 6A applies, the principal amount of a relevant capital instrument issued by the bank must not be reduced under this section to a greater extent, or converted on worse terms, than equally ranked capital instruments at the level of any parent undertaking of the bank which are reduced, or converted, pursuant to Article 59 of the recovery and resolution directive or in the course of applying the bail-in tool provided for by that directive.

(10) In this section “parent undertaking” has the meaning given by Article 4.1(15)(a) of the capital requirements regulation.

Mandatory reduction instruments: implementation of requirements of section 6B

6C.—(1) Where the principal amount of a relevant capital instrument is reduced under section 6B—

- (a) the reduction must be permanent, subject to any provision made by virtue of section 48Y(1)(a)(5);
- (b) no liability to the holder of the relevant capital instrument remains under, or in connection with, so much of the amount of the instrument as constitutes the reduction, except for—

(4) Inserted by article 70 of this Order.

(5) Section 48Y is inserted by article 61 of this Order.

- (i) any liability already accrued in a case where the principal amount of the instrument is not reduced or converted (or both) to the full extent of its capacity, and
 - (ii) any liability for damages that may arise as a result of any challenge to the legality of the exercise of the power of reduction;
- (c) no compensation is to be paid to any holder of the relevant capital instrument other than in accordance with subsection (4).
- (2) Nothing in subsection (1)(b) prevents the provision of Common Equity Tier 1 instruments to a holder of relevant capital instruments in accordance with subsection (4).
- (3) In order to effect a conversion of relevant capital instruments under section 6B, the Bank of England may require the bank, or a UK parent undertaking, to issue Common Equity Tier 1 instruments to the holders of the relevant capital instruments.
- (4) The relevant capital instruments may only be so converted if—
 - (a) the Common Equity Tier 1 instruments are issued by the bank, or by a parent undertaking of the bank with the agreement of the resolution authority in respect of that parent undertaking,
 - (b) the Common Equity Tier 1 instruments are issued prior to the issue of any shares by the bank, or by a parent undertaking of the bank, for the purposes of provision of own funds by the State or a government entity,
 - (c) the Common Equity Tier 1 instruments are awarded and transferred without delay following the exercise of the conversion power, and
 - (d) the conversion rate that determines the number of Common Equity Tier 1 instruments that are provided in respect of each relevant capital instrument complies with—
 - (i) the principles set out in Article 50 of the recovery and resolution directive, and
 - (ii) any guidelines issued by the European Banking Authority under Article 50(4) of the resolution and recovery directive, other than any guidelines which the Bank of England has notified the Authority it does not intend to comply with.
- (5) For the purposes of the provision of Common Equity Tier 1 instruments in accordance with subsections (2), (3) and (4), the Bank of England may require the bank or a UK parent undertaking of the bank to maintain at all times the necessary prior authorisation to issue the relevant number of Common Equity Tier 1 instruments.
- (6) Before making a mandatory reduction instrument, the Bank must consult—
 - (a) the PRA,
 - (b) the FCA, and
 - (c) the Treasury.
- (7) In this section—
 - “parent undertaking” has the meaning given by Article 4.1(15)(a) of the capital requirements regulation,
 - “resolution authority” has the meaning given by Article 2.1(18) of the recovery and resolution directive,
 - “UK parent undertaking” means a parent undertaking that is incorporated in, or formed under the law of, any part of the United Kingdom.

Mandatory reduction instruments: supplementary matters

6D.—(1) The following provisions apply in relation to a mandatory reduction instrument as they apply to a resolution instrument—

- (a) section 48L(3) and (5) (powers relating to securities issued by the bank),
- (b) section 48O (power to direct directors of the bank),
- (c) section 48Q (continuity),
- (d) section 48R (execution and registration of instruments etc),
- (e) section 48S (general matters), and
- (f) section 48T (procedure).

(2) Where the Bank of England makes one or more mandatory reduction instruments in respect of a bank, the Bank must, on request by the Treasury, report to the Chancellor of the Exchequer about—

- (a) the exercise of the power to make a mandatory reduction instrument,
- (b) the activities of the bank, and
- (c) any other matters in relation to the bank that the Treasury may specify.

(3) In relation to the matters in subsection (2)(a) and (b), the report must comply with any requirements that the Treasury may specify.

(4) The Chancellor of the Exchequer must lay a copy of each report under subsection (2) before Parliament.”