

EXPLANATORY MEMORANDUM TO
THE BANK RECOVERY AND RESOLUTION (NO. 2) ORDER 2014

2014 No. 3348

- 1.** This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument is one of the instruments made to implement Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (the “BRRD”).

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 This instrument is designed to implement certain requirements of the BRRD. It should be read in conjunction with the Bank Recovery and Resolution 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, the Banks and Building Societies (Depositor Preference and Priorities) Order 2014 and the Building Societies (Bail-In) Order 2014.

4.2 It sets out the procedural requirements that the Bank of England, the Prudential Regulation Authority (PRA), Financial Conduct Authority (FCA) and the Treasury must follow when exercising their powers and functions under the BRRD, which in the UK are implemented through the Banking Act 2009 and the Financial Services and Markets Act 2000. These functions are primarily planning for or managing the failure of a bank, building society or investment firm (collectively referred to as “institutions”) or other companies in the same group as an institution, or otherwise acting to achieve one or more of the special resolution objectives, which include protecting and enhancing the stability of the financial and banking system, ensuring the continuation of critical functions and protecting depositors and public funds.

4.3 The BRRD was given scrutiny clearance by the House of Lords European Union Committee on 12 June 2013¹ and by the House of Commons European Scrutiny Committee on 21 June 2013².

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

“In my view the provisions of the Bank Recovery and Resolution (No. 2) Order 2014 are compatible with the Convention rights.”

7. Policy background

- What is being done and why

7.1 The BRRD entered into force on 2 July 2014. The Directive establishes a common approach within the EU to the recovery and resolution of credit institutions (in the UK, banks and building societies) and investment firms (“institutions”). The Directive aims to provide member States with a common framework for the resolution of institutions and, in the case of groups, parent and subsidiary undertakings of institutions.. It also ensure cooperation between member States, and with third countries, in planning for and managing the failure of cross-border firms.

7.2 The UK’s Special Resolution Regime (SRR) is set out in the Banking Act 2009. It provides the Bank of England, as the resolution authority, with a number of stabilisation options designed to enable them to manage the failure of institutions and banking group companies – by transferring ownership to a private sector purchaser, transferring some or all of the business of the bank to a subsidiary of the Bank of England (known as a bridge bank) or by cancelling or reducing liabilities of the bank in order to recapitalise it.

7.3 The Bank Recovery and Resolution (No. 2) Order sets out the procedural requirements on the Bank of England, the PRA, the FCA and the Treasury (collectively referred to as “the Authorities”) when performing their functions under the BRRD. This includes how they interact with the institutions subject to the SRR, how the Authorities interact with each other, and how they interact with counterparts in other EEA member states.

¹ <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmeuleg/83-v/8318.htm>

² <http://www.parliament.uk/documents/lords-committees/eu-sub-com-a/CWM/cwm2013-14/CwMsubA9May13-30Nov13-.pdf> – see p.9

7.4 The Bank Recovery and Resolution (No. 2) Order amends the Financial Services and Markets Act 2000, to ensure that the provisions relating to recovery and resolution planning (which require institutions to put in place plans to recover from a severe financial stress, and to provide information that will assist the Authorities in exercising their functions) comply with the requirements of the BRRD. It amends the definition of “financial institutions” in the Financial Services and Markets Act 2000 (Prescribed Financial Institutions) Order 2013 to include mixed activity holding companies in limited circumstances. This gives the PRA and FCA the power to make rules for mixed activity holding companies in relation to the provision of financial support between entities in the same group, and requiring mixed activity holding companies to notify them in the event that the company is failing or likely to fail. Where a mixed activity holding company directly holds an institution (i.e. it has not established an intermediate financial holding company that holds the subsidiary) it enables the PRA and FCA to make rules placing requirements on the mixed activity holding company to include certain contractual terms in any liabilities governed by the law of a non-EEA country.

7.5 The Order modifies the application of the Companies Act 2006 for institutions in relation to which the stabilisation powers in the Banking Act 2009 have been exercised, so that certain shareholder rights are not engaged, facilitating the use of the stabilisation powers. Similarly, it removes the obstacles to effective resolution potentially presented by legislation on company mergers and divisions (including cross-border mergers) and on share issues. It amends other secondary legislation, including the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001, the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 and the Financial Collateral (No 2) Regulations 2003, to give effect to obligations in the BRRD.

7.6 The Government considers that any alternatives to legislation are not generally appropriate in this case, since the BRRD requires that resolution authorities have substantial powers to interfere with property rights, where justified and proportionate to the public interest. It is therefore necessary that these powers, and the procedures by which they are exercised, are set out in legislation with appropriate safeguards, in order to provide a sufficient level of certainty and clarity for those whose rights may be affected.

7.7 The Government has used copy-out wherever it considers that this gives the necessary clarity and is consistent with existing UK legislation. A copy-out approach has not been adopted for the Directive as a whole, because the Government does not consider that the language of the Directive is in all cases sufficiently clear and precise. Using copy-out in these cases would lead to material uncertainty for investors and others who may be affected by this legislation, and who therefore need complete clarity on how it operates.

- Consolidation

7.8 Consolidation with previous orders or regulations is not relevant. The Bank Recovery and Resolution (No. 2) Order makes limited amendments to existing legislation. It is not considered necessary to produce consolidated versions. Commercial publishers produce consolidated versions of the Act, and of secondary legislation made under it, both in electronic and hard copy versions.

8. Consultation outcome

8.1 A consultation on transposition of the BRRD was published on 23rd July 2014 and closed on 28th September 2014. In accordance with current guidance on consultations, this period was judged to be sufficient to allow industry to consider the proposals, while also allowing time for the legislation to be completed by 31st December 2014 as required by the BRRD. During the consultation period, the Treasury also met with a number of industry bodies and banks.

8.2 The Treasury received a total of 14 responses to the consultation from banks, building societies, pension funds and industry groups. The responses were generally positive about the approach suggested by the Government, subject to some concerns about specific provisions.

8.3 Every respondent who expressed an opinion on the issue agreed with the proposal in the consultation to delay the application of the “Minimum Requirement for Eligible Liabilities” provisions until 2016, as permitted by the Directive. The Bank Recovery and Resolution (No. 2) Order therefore delays the commencement of the relevant Part of the Order to deliver that outcome.

8.4 Respondents also agreed with the proposed approach to mixed-activity holding companies. This included limiting the PRA’s and FCA’s new rule making powers to agreements between companies in the same group to provide financial support to each other; and a requirement on mixed-activity holding companies to notify the PRA or FCA when it is failing or likely to fail; and a requirement to include in any agreement which creates a liability a term by which a party to the agreement to whom the liability is owed acknowledges the potential impact of the exercise of stabilisation powers, which only applies to a mixed activity holding companies where it holds a banking institution as a group subsidiary directly (i.e. it has not established an intermediate financial holding company that holds the subsidiary).

9. Guidance

9.1 The Banking Act 2009 requires the Treasury to issue a Code of Practice providing guidance on the use of the stabilisation powers. The Code is not considered essential to understanding how the instrument will operate – rather, it sets out how the Authorities expect to exercise their powers under the Banking Act 2009. The Code will be updated to reflect the changes made by these instruments, and the update will be published in January 2015.

10. Impact

10.1 For the package of instruments introduced to transpose the BRRD as a whole, the impact of on business, charities or voluntary bodies is estimated to be between £298.0m and £837.4m per year. These costs arise due to the higher cost of funding for banks,

building societies and investment firms expected due to the bail-in tool and preferring deposits to unsecured creditors. They do not arise as a result of measures in the Bank Recovery and Resolution (No. 2) Order, but rather the amendments to the Banking Act 2009 made by the Bank Recovery and Resolution Order.

10.2 The impact on the public sector is estimated to be around £494k per year due to higher costs to the authorities. This arises through higher levels of supervision and implementation costs. These costs may fall over time as the BRRD is embedded.

10.3 An impact assessment has not been produced for this instrument as no significant impact on the costs of business or the voluntary sector is foreseen.

11. Regulating small business

11.1 The legislation applies to small businesses.

11.2 While no deposit-taking banks or building societies in the UK are likely to meet the definition of a small or medium-sized enterprise (SME) there may be investment firms which are small businesses and are covered by this legislation.

11.3 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is for the legislation to include a public interest test for exercise of the resolution powers in the Banking Act 2009, and to provide for simplified obligations to apply to firms whose failure would be unlikely to have a significant negative effect on financial markets or the wider economy. The factors taken into consideration in determining whether this is the case include an institution's size, the scope of its activities, its risk profile and/or its interconnectedness to the rest of the financial system.

12. Monitoring & review

12.1 This instrument is designed to implement the BRRD and ensure that the UK authorities have the necessary powers to plan for and manage the failure of a bank or investment firm whose failure has the potential to damage the UK economy and financial system, or public confidence in that system. A full assessment of the extent to which it delivers that objective may only be possible in the event that such a failure occurs, and the full set of powers is used.

12.2 The instruments include a requirement for the Treasury to review the legislation within 5 years, and periodically following that, at least once every 5 years.

13. Contact

Catherine McCloskey at HM Treasury Tel: 020 7270 5377 or email: catherine.mccloskey@hmtreasury.gsi.gov.uk can answer any queries regarding these instruments.