

### Brexit Statutory Instruments – a series of briefings

*November 2018*

## Bank Recovery and Resolution (Amendment) (EU Exit) Regulations 2018

This paper is part of a series of briefings for clients and contacts of Allen & Overy on the review of financial services statutory instruments (SIs) to be laid down under the European Union (Withdrawal) Act 2018 (the **Withdrawal Act**).

### Introduction

The purpose of the SIs is to help with a range of legal issues caused by the UK's exit from the EU and to prevent, remedy or mitigate any failure of EU law to operate effectively or any other deficiency in retained EU law. SIs are not intended to make policy changes, other than to reflect the UK's new position outside the EU. The changes in the SI will not take effect on 29 March 2019 if a transitional agreement is reached.

### The Bank Recovery and Resolution Directive

The Banking Act 2009 established the UK's Special Resolution Regime (**SRR**), providing the UK regulatory authorities with tools to protect financial stability by effectively resolving banks, building societies, investment firms and other entities that are failing or likely to fail, while protecting taxpayers, depositors and the economy.

The Bank Recovery and Resolution Directive (2014/59/EU) (**BRRD**) introduced an EU-wide framework for the recovery and resolution of EU credit institutions and significant investment firms that were failing or likely to fail. It sought to provide national authorities with harmonised powers to tackle financial crises in banks and investment firms. The BRRD also established mechanisms for cooperation between resolution authorities in applying resolution tools and powers to financial groups operating on a cross-border basis.

The Banking Act 2009 was amended to implement the BRRD via a number of statutory instruments.

### What does the BRRD SI do?

The Bank Recovery and Resolution (Amendment) (EU Exit) Regulations 2018 (**BRRD SI**) seeks to ensure that the UK's SRR works legally and practically once the UK has left the EU. The BRRD's policy drivers will remain central to the framework, ensuring continuity and certainty on Brexit. The BRRD SI assumes that there will be no cooperation with EU authorities.

### Align the treatment of EU states with that of third countries in UK legislation

In the absence of a Brexid deal, the UK would treat EU member states in the same way as other third countries. In the resolution context, this would mean that EU-led resolutions should be recognised by the UK unless doing so would be contrary to relevant UK statutory safeguards. Post-Brexid, the UK would extend its third country recognition framework, which applies to third country resolution actions that are broadly comparable in objectives and resolution actions taken under the UK regime, to include EU-led resolutions.

### Remove the BRRD's operational and procedural mechanisms

UK regulators are currently required to follow operational and procedural mechanisms set out in the BRRD to cooperate with other EU authorities. This includes the UK's participation in European resolution colleges, joint assessment and decision-making between UK and EU regulators. Once the UK leaves the EU, the BRRD would no longer apply to the UK and the BRRD SI therefore removes these mechanisms from the UK regime. It should be noted that such changes to the UK regime would not prevent the UK regulators from cooperating with EU regulators and authorities, UK authorities would continue to be able to share information with the EU in the same way as with third countries.

### Cross references to the BRRD (and other EU legislation)

The BRRD SI copies out cross references to the BRRD and other EU legislation to retain key concepts under UK law that would otherwise be lost. This is intended to avoid changing underlying policy drivers. It should be noted that cross references to the EU Capital Requirements Regulation, the EU Market Abuse Regulation and the European Market Infrastructure Regulation are to such regulations as they have effect on the day on which the BRRD SI is made (rather than the day on which the UK leaves the EU).

### The approach towards the BRRD's retained direct EU legislation

The BRRD SI seeks to amend UK domestic law that implements the BRRD and accompanying regulations incorporated into UK law by the Withdrawal Act with the aim of ensuring the continued functioning of UK statute. In addition to the BRRD SI, the UK regulators will update their rulebooks and policies to take account of and rectify any deficiencies resulting from the UK's withdrawal from the EU.

#### Legislation amended by the BRRD SI<sup>1</sup>

- The Banking Act 2009
- The Insolvency Act 1986
- The Bank Recovery and Resolution (No. 2) Order 2014
- The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009
- The Banking Act 2009 (Banking Group Companies) Order 2014
- The Bank Recovery and Resolution Order 2014
- The Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations 2014
- The Banking Act 2009 (Restriction of Special Bail-in Provision, etc) Order 2014
- The Building Societies (Bail-in) Order 2014
- The Bank Recovery and Resolution Order 2016

<sup>1</sup> **Retained direct EU legislation revoked by the BRRD SI:** Commission Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to ex ante contributions to resolution financing arrangements; Commission Delegated Regulation (EU) 2016/1434 of 14 December 2015 correcting Delegated Regulation (EU) 2015/63 of the European Parliament and of the Council with regard to ex ante contributions to resolution financing arrangements; Commission Delegated Regulation (EU) 2017/867 of 7 February 2017 on classes of arrangements to be protected in a partial property transfer under Article 76 of Directive 2014/59/EU of the European Parliament and of the Council.

**Retained direct EU legislation amended by the BRRD SI:** Commission Delegated Regulation (EU) 2016/778 of 2 February 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary ex post contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines; Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms.

## Areas identified by industry as requiring further consideration

Although the intention of the BRRD SI is to onshore the BRRD with as little change as possible to ensure the continued functioning of UK law, there are a number of resolution issues arising as a result of Brexit that the industry has identified as potentially requiring further consideration.

### Treating EU states as third countries

Treating EU member states as third countries across the BRRD framework has consequences that are not aligned with the Withdrawal Act's general rule of ensuring that the same rules and laws will apply post Brexit as they did before.

- i) **Resolution colleges** – In order for the Bank of England to continue participating in EU resolution colleges as an observer, it must first request and then be invited to observe. The BRRD SI could include wording to assist the Bank of England's participation in the resolution colleges such as requiring the Bank of England to remain within the EU resolution colleges<sup>2</sup> in which it currently participates, as far as possible under applicable law.
- ii) **Recognition of third country resolution actions** – As EU member states would be treated as third countries, the Bank of England would only be able to recognise a resolution action by an EU resolution authority with the approval of HM Treasury. In the interests of legal certainty, and effective management of cross EU/UK resolutions, wording could be included in the BRRD SI to ensure that the approval process is efficient and could provide a time limit for approval.
- iii) **Recognition of bail-in** – Article 55 of the BRRD requires the contractual recognition of EU bail-in powers, among other things, where a relevant contract is governed by the law of a third country. This may be problematic for contracts and securities issued by EU banks but governed by English law in force post Brexit as certain contracts cannot be amended without counterparty consent (which may be impossible to obtain). It may also question the ability of EU banks to contract and issue securities under English law post Brexit.

The BRRD SI could be updated to include a provision making clear that the UK would recognise EU resolution actions to avoid such concerns. The UK regulatory rulebooks could also be modified to ease compliance of UK institutions in respect to future contracts made with EU counterparties. The industry has requested engagement and consultation to assess any potential impacts on financial stability and suggested that the UK authorities should engage with the Single Resolution Board and European Central Bank to ensure transitional provisions are in place where necessary to assist EU and UK firms.

### Broader implications

Although the SIs are not intended to effect policy changes, Brexit has wider implications on cross-border resolution. These include:

- how HM Treasury intends to implement BRRD II which is likely to be adopted prior to Brexit
- the potential to develop a statutory basis for UK-led resolution colleges
- addressing the structural mismatch created by the preference of UK depositors over third country deposits in the creditor hierarchy

## What does this mean for you?

In order to onshore the BRRD changes to the PRA Rulebook will be required which may impact UK institutions. And issues such as the application of Article 55 of the BRRD to an EU institution's English law governed contracts and continued eligibility of English law governed MREL could potentially have a substantial impact for institutions.

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<sup>2</sup> Especially for resolution planning and MREL setting, for example.

## Next steps

- HM Treasury intends to put the BRRD SI before Parliament this Autumn.
- HM Treasury intends to update the Special Resolution Regime Code of Practice after the SI has been laid to provide further clarity on the SI's amendments to the UK's SRR.

## Your Allen & Overy contacts

For further information please speak to one of Allen & Overy's London Financial Services Partners: Bob Penn, Damian Carolan, Etay Katz, Kate Sumpter, Nick Bradbury, Ben Regnard-Weinrabe or your usual Allen & Overy contact.

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