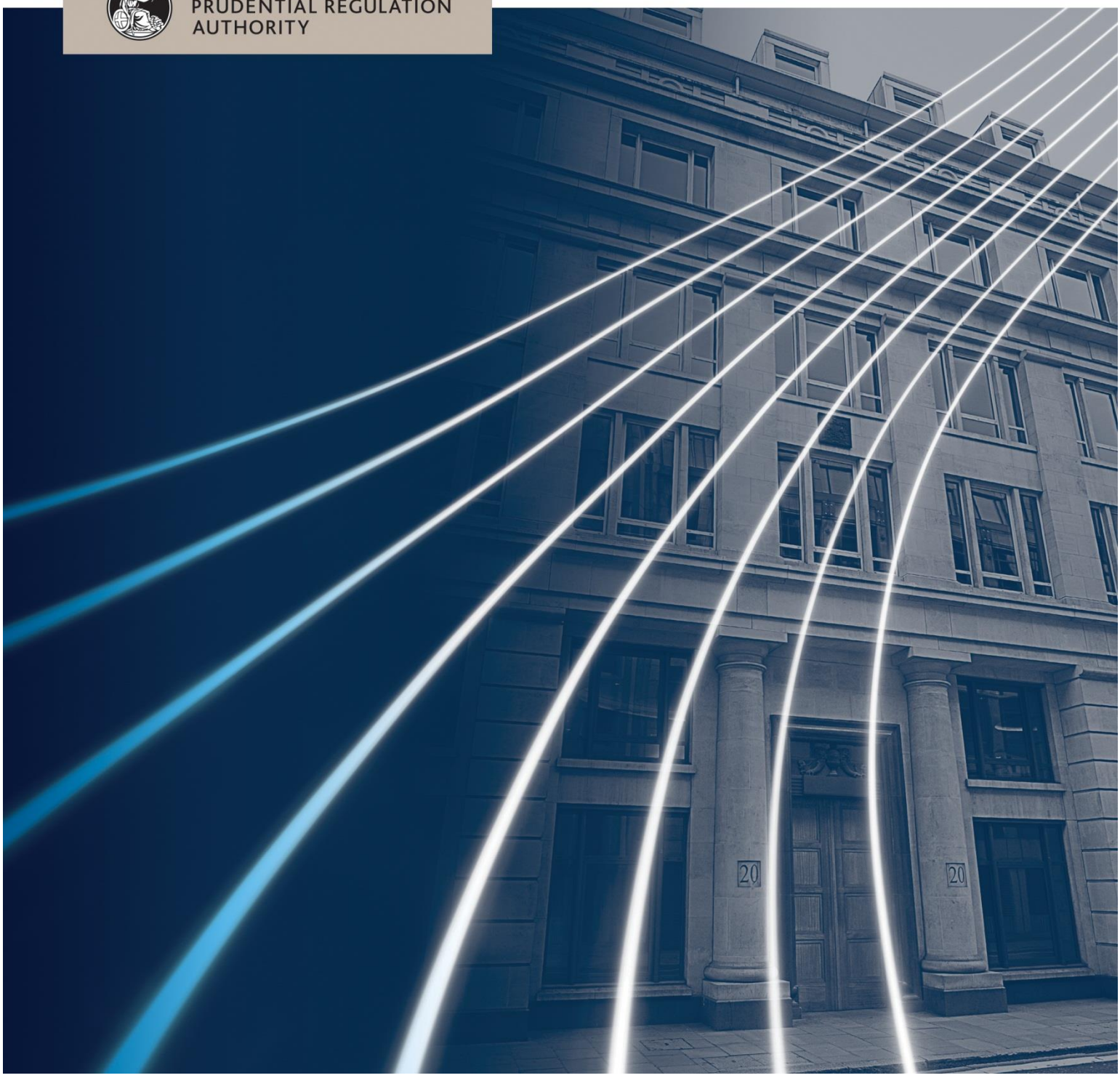
Policy Statement | PS17/16

The contractual recognition of bail-in: amendments to Prudential Regulation Authority rules

June 2016



Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

Prudential Regulation Authority, registered office: 8 Lothbury, London EC2R 7HH.
Registered in England and Wales No: 07854923

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Policy Statement | PS17/16

The contractual recognition of bail-in: amendments to Prudential Regulation Authority rules

June 2016

This policy statement (PS) provides feedback on responses received to Consultation Paper (CP) 8/16 'The contractual recognition of bail-in: amendments to Prudential Regulation Authority rules'. The appendices to this PS set out the final rules on contractual recognition and the final supervisory statement on impracticability.

Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback on responses to Consultation Paper (CP) 8/16 'The contractual recognition of bail-in: amendments to Prudential Regulation Authority rules'.[1] It sets out the final rules and supervisory statement (SS) intended to implement Article 55 of the Bank Recovery and Resolution Directive (BRRD). The rules will come into force on 1 August 2016.

1.2 Article 55 requires firms to include in certain non-EU law contracts governing liabilities a term by which the relevant creditor or party to the contract recognises that the liability may be bailed in by the Bank of England as resolution authority.

1.3 This PS is relevant to BRRD undertakings[2] to which the Contractual Recognition Part of the PRA Rulebook applies[3], hereafter referred to as 'BRRD firms.'

1.4 In CP8/16, the PRA proposed to:

- amend the Contractual Recognition Of Bail-In Part of the PRA Rulebook to provide that firms must include contractual recognition language into 'phase 2' liabilities governed by non-EU law, unless this is impracticable. 'Phase 2' liabilities cover liabilities other than unsecured debt instruments which are in scope of the contractual recognition requirement. To help firms determine impracticability, the CP included a draft SS outlining instances in which the inclusion of contractual recognition language may be impracticable; and

- further amend the Contractual Recognition Of Bail-in Part of the PRA Rulebook in order to ensure consistency with a set of regulatory technical standards (RTS) on contractual recognition published by the European Banking Authority (EBA) in July 2015. The RTS further determines the list of liabilities excluded from the recognition requirement and specifies the contents of the contractual term. In line with the RTS, the PRA proposed to:

    - require the inclusion of contractual recognition language into contracts for liabilities which are not fully secured and secured liabilities which are not under a continuous full collateralisation requirement in accordance with EU or equivalent third country law;

    - require the inclusion of contractual recognition language into liabilities created before the date of application of the contractual recognition requirement if the agreement governing the liability is subject to a material amendment after 30 June 2016; and

    - replace the reference to liabilities 'arising' after a certain date in PRA rules with a reference to liabilities 'created' after that date. The amendment ensures consistency with the RTS and provides greater clarity as to which liabilities are in scope of the contractual recognition requirement.

[1] See www.bankofengland.co.uk/pra/Pages/publications/cp/2016/cp816.aspx.
[2] See PRA Rulebook: www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52268/19-02-2016.
[3] See PRA Rulebook: www.prarulebook.co.uk/rulebook/Content/Part/211722/

1.5 The final rule and SS address the broad scope of the contractual recognition requirement and acknowledge that the inclusion of contractual recognition language is in some instances impracticable. The proposals to amend the PRA Rulebook follow a modification by consent issued by the PRA in November 2015. The modification provided an interim solution while the consultation was carried out. The modification originally disapplied the contractual recognition requirement for the 1 January 2016 to 30 June 2016 period for 'phase 2' liabilities where compliance with the requirement was impracticable. The PRA has extended the modification by one month until 31 July 2016. The final PRA rules come into force on 1 August 2016.

1.6 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to publish a statement on the impact of rules on PRA authorised persons which are mutual societies where the final rule applies to both PRA authorised persons which are mutual societies and other PRA authorised persons and differs from the draft of the proposed rule.[1] In the PRA's opinion, the impact of the rules as made is not significantly different from the impact of the proposed rules on PRA authorised persons which are mutual societies as compared with other PRA authorised persons.

1.7 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made.

1.8 Overall, the PRA does not consider that the responses received to CP8/16 require significant changes to its proposals. The PRA has however amended its definitions of an 'unsecured liability', of a 'material amendment' and of an 'excluded liability' in the PRA Rulebook to add further clarity and ensure consistency with the RTS on contractual recognition as adopted by the European Commission in March 2016.[2] The PRA has also amended the PRA rules to reflect the fact that the amendments will come into force on 1 August 2016, rather than 1 July, as anticipated in CP8/16. The PRA has not made any further changes beyond these amendments. The PRA has also not made any changes to the SS as consulted on.

2 Responses to feedback

2.1 The PRA received eleven responses to CP8/16. This section sets out the changes made to the definitions in the PRA Rulebook and clarifies the CP8/16 proposals in light of consultation feedback.

i) Amendments to 'unsecured liability'

2.2 Respondents noted that the proposed definition of 'unsecured liability' makes it unclear whether liabilities under a repurchase transaction or other title transfer collateral arrangements created on or before 31 July 2016 are in scope of the contractual recognition requirement. It was not the intention for these liabilities to be in scope of the unsecured liability definition and the PRA has clarified this in the revised drafting:

"unsecured liability means in respect of liabilities created on or before ~~30 June~~ 31 July 2016, a liability under which the right of the creditor to payment or other form of performance is not (i) secured by a charge, pledge, lien or mortgage, or (ii) subject to other collateral arrangements, including liabilities arising from repurchase transactions and other title transfer collateral arrangements; and in respect of liabilities created after ~~30 June~~ 31 July 2016, a liability that is not a fully secured liability."

1 Section 138K of FSMA.
2 See http://ec.europa.eu/finance/bank/docs/crisis-management/160523b-delegated-regulation_en.pdf

ii) The RTS on contractual recognition: Amendments to 'material amendment', 'excluded liability' and clarifications

2.3 The RTS on contractual recognition had not been adopted by the European Commission when the PRA published CP8/16 and the PRA had based its proposals on the draft RTS. The PRA noted it may need to make further amendments to its rules to ensure consistency with the RTS as adopted by the European Commission.

2.4 The Commission adopted the RTS on 23 March 2016. Having reviewed the RTS, the PRA made one insubstantial change to the definition of a material amendment to ensure consistency of wording between the PRA rules and the RTS as set out below:

"material amendment means an amendment to an agreement, including an automatic amendment, which affects the substantive rights and obligations of a party to the agreement. Amendments which are not material amendments include ~~such as~~ a change to the contact details of a signatory or the addressee for the service of documents, typographical changes to correct drafting errors or automatic adjustment to interest rates ~~are not *material amendments*~~."

2.5 The PRA has also amended the definition of an 'excluded liability' to clarify that, in order to qualify as an excluded liability, the requirement that a secured liability created after 31 July 2016 be a fully secured liability only applies for the purposes of subsection 48(B)(8)(b) of the Banking Act 2009, and not to any other sub-sections of section 48B(8). This is consistent with the RTS.

2.6 Respondents also had further questions on the substance of the RTS. Firms asked whether impracticability could be invoked in relation to liabilities which are fully collateralised on a continuous basis but where such collateralisation is not mandated by regulatory requirements.

2.7 The PRA notes that such liabilities are 'phase 2' liabilities and fall within the scope of the impracticability consideration. As set out in the SS, firms need to make their own reasoned assessment with regard to impracticability in relation to 'phase 2' liabilities and reach a view as to whether they are in compliance with the amended PRA rules.

iii) Examples of impracticability

2.8 Respondents asked the PRA to provide more examples of situations in which it may be impracticable to include the contractual recognition language.

2.9 The PRA has not provided additional examples and expects BRRD firms to make their own reasoned assessment with regard to impracticability in relation to 'phase 2' liabilities and reach a view as to whether they are in compliance with the amended PRA rules.

iv) Third country authorities and impracticability

2.10 In the draft SS, the PRA indicated that impracticability considerations may apply if relevant third country authorities have informed the firm in writing they would not allow it to include the recognition language. Respondents asked whether 'third country authority' covered also counterparties which share the characteristics of a third country authority, such as official export credit agencies, multilateral development banks or international organisations.

2.11 The PRA intends 'third country authority' to cover only those authorities which have responsibility for financial stability, financial conduct, financial supervision or resolution matters.

v) Trade finance liabilities

2.12 In the draft SS, the PRA indicated that impracticability considerations may apply if the creation of liabilities is governed by international protocols which the firm has no power to amend. Respondents asked if impracticability would apply to all trade finance liabilities, whether governed by international protocols or not.

2.13 Firms should include contractual recognition language into trade finance liabilities if this is not impracticable. One instance where it might be impracticable to include contractual recognition language into trade finance liabilities is if these liabilities are governed by international protocols.

vi) The PRA definition of 'liability'

2.14 The PRA did not consult on the definition of 'liability' in CP8/16. Nonetheless, respondents raised concerns about the existing definition in the PRA Rulebook. They noted that the BRRD does not define a liability and asked the PRA to narrow the definition or delete it altogether.

2.15 The PRA does not propose to amend the definition of a liability. The definition is aligned with the definition of a liability used in UK insolvency law.[1] The PRA has taken this approach to provide clarity for firms.

[1] Bank Insolvency (England and Wales) Rules 2009, rule 262 (SI 2009/356).

Appendices

1	**PRA Rulebook: CRR FIRMS AND NON-AUTHORISED PERSONS: CONTRACTUAL RECOGNITION OF BAIL-IN AMENDMENT INSTRUMENT 2016, available at http://www.bankofengland.co.uk/pra/Pages/publications/ps/2016/ps1716.aspx**
2	**Supervisory Statement 7/16- 'The contractual recognition of bail-in – impracticability', available at http://www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss716.aspx**