



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

Consultation Paper | CP8/16

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

March 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



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Responses are requested by Monday 16 May 2016.

**Please address any comments or enquiries to:**

Dana Andreicut  
Prudential Regulation Authority  
20 Moorgate  
London  
EC2R 6DA

Email: [CP8\\_16@bankofengland.co.uk](mailto:CP8_16@bankofengland.co.uk)



## Contents

<b>1</b>	<b>Overview</b>	<b>5</b>
<b>2</b>	<b>Impracticability</b>	<b>6</b>
<b>3</b>	<b>The Regulatory Technical Standards on contractual recognition</b>	<b>7</b>
<b>4</b>	<b>Approach to supervision</b>	<b>8</b>
<b>5</b>	<b>The PRA's statutory obligations</b>	<b>9</b>
	<b>Appendices</b>	<b>12</b>



## 1 Overview

1.1 In this consultation paper (CP) the Prudential Regulation Authority (PRA) puts forward proposals to amend the Contractual Recognition of Bail-In Part of the PRA Rulebook, along with a draft supervisory statement reflecting the PRA's expectations. The proposals are consistent with the modification by consent published by the PRA in November 2015.<sup>1</sup>

1.2 This CP is relevant to Bank Recovery and Resolution Directive (BRRD) undertakings<sup>2</sup> to which the Contractual Recognition Part of the PRA Rulebook applies,<sup>3</sup> hereafter referred to as 'BRRD firms.'

1.3 Current PRA rules on contractual recognition require BRRD firms to include in non-EU law contracts governing liabilities a term by which the creditor recognises that the liability may be bailed in by the Bank of England as the resolution authority. The rules implement Article 55 of the BRRD.<sup>4</sup>

1.4 The contractual recognition requirement is designed to ensure the effectiveness of the bail-in tool<sup>5</sup> in a cross-border resolution and to promote equal treatment between EU and third-country liability holders. The requirement is in line with the Financial Stability Board's (FSB) international standard for effective resolution regimes (the Key Attributes).<sup>6</sup> The BRRD and the United Kingdom implementing legislation are designed to reflect the Key Attributes.

1.5 The Key Attributes regard statutory recognition frameworks across jurisdictions as essential for effective cross-border resolutions. However, until all relevant jurisdictions adopt comprehensive statutory regimes, contractual arrangements provide an interim solution. Even with statutory regimes in place, such arrangements help reinforce the legal certainty and predictability of cross-border resolution.<sup>7</sup>

1.6 The scope of current PRA rules on contractual recognition is broad and there may be circumstances where BRRD firms find compliance with the requirement impracticable. For instance, BRRD firms may have liabilities under contracts governed by international protocols which they have no power to amend. Contractual terms can also be imposed on firms by virtue of their membership in non-EU bodies, whose use is necessarily on standard terms for all members and impractical to amend bilaterally.

1.7 To address such concerns, the PRA published a modification by consent which disapplies the rules for a subset of liabilities where compliance is impracticable and where BRRD firms have notified the PRA that they consent to the modification. The modification expires on 30 June 2016 and this CP proposes an amendment to the PRA rules to the same effect as the modification. The PRA proposes that the amended rules would apply from 1 July 2016.

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1 See 'PRA Modification by Consent of Contractual Recognition of Bail-in rules 1.2 & 2.1': [www.bankofengland.co.uk/prarulebook/Pages/authorisations/waivers/waiversbyconsent.aspx](http://www.bankofengland.co.uk/prarulebook/Pages/authorisations/waivers/waiversbyconsent.aspx).

2 See PRA Rulebook: [www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52268/19-02-2016](http://www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52268/19-02-2016).

3 See PRA Rulebook: [www.prarulebook.co.uk/rulebook/Content/Part/211722/](http://www.prarulebook.co.uk/rulebook/Content/Part/211722/).

4 Directive 2014/59/EU of the European Parliament and the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council; <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014L0059&from=EN>.

5 See Part 3 'Bail-in Stabilisation Option' of the Banking Reform Act 2013, <http://www.legislation.gov.uk/ukpga/2013/33/contents/enacted>.

6 'Key Attributes of Effective Resolution Regimes for Financial Institutions', Financial Stability Board, October 2014; [www.financialstabilityboard.org/2014/10/r\\_141015/](http://www.financialstabilityboard.org/2014/10/r_141015/).

7 See Principles 7 and 9 of 'Principles for Cross-Border Effectiveness of Resolution Actions', Financial Stability Board, 3 November 2015: [www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf](http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf).

1.8 The CP also puts forward three additional technical amendments to PRA rules to ensure consistency between the rules and the final draft European Banking Authority (EBA) Regulatory Technical Standards (RTS) on the contractual recognition of bail-in due to be adopted shortly by the European Commission. The amendments, covered in chapter 3, are:

- the inclusion of contractual recognition language into contracts for liabilities which are not fully secured and for secured liabilities which are not under a continuous full collateralisation requirement in accordance with EU or equivalent third-country law;
- 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;
- the replacement of the reference to liabilities ‘arising’ after a certain date in PRA rules with a reference to liabilities ‘created’ after that date. The amendment intends to ensure consistency with the draft RTS and provide greater clarity as to which liabilities are in scope of the contractual recognition requirement.

1.9 Chapter 4 considers the PRA’s approach to supervision in relation to the contractual recognition requirement.

1.10 Chapter 5 considers the PRA’s statutory obligations.

## **Responses and next steps**

1.11 This consultation closes on Monday 16 May 2016. The PRA invites feedback on the proposals set out. Please address any comments or enquiries to [cp8\\_16@bankofengland.co.uk](mailto:cp8_16@bankofengland.co.uk).

## **2 Impracticability**

2.1 This chapter sets out the PRA’s proposals to amend the Contractual Recognition of Bail-In Part of the PRA Rulebook to introduce the consideration of impracticability. The amended rules are proposed to enter into force on 1 July 2016.

2.2 PRA rules currently require BRRD firms to include contractual recognition of bail-in language into liabilities unless firms have applied for a modification by consent. The modification builds on the PRA’s phased approach to implementing the contractual recognition requirement and disapplies the rule for ‘phase 2’ liabilities (ie unsecured liabilities which are not debt instruments) in circumstances where compliance would be impracticable. The modification expires on 30 June 2016.

2.3 The PRA is proposing an amendment to its rules to provide that BRRD firms must include contractual recognition language into phase 2 liabilities unless this is impracticable.

2.4 The PRA expects BRRD firms to make a reasoned assessment as to whether the inclusion of contractual recognition language in the terms of a given phase 2 liability is impracticable. The supervisory statement in Appendix 2 sets out examples of situations where this may be the case.

2.5 For instance, BRRD firms may regard the inclusion of recognition language impracticable if a relevant third-country authority has informed the firm that they would not allow the inclusion of such language or that local laws would not permit it. Firms could also reach this



view if liability contracts are governed by international protocols, which the firm has no power to amend.

2.6 The impracticability consideration could for instance apply to liabilities used for the purposes of trade finance. Such liabilities often fall under standard international documentation and may not be practicably amendable by firms.

2.7 The supervisory statement also sets out that the PRA does not consider loss of competitiveness or profitability as grounds for compliance being impracticable, as this is not consistent with the policy intent of the contractual recognition requirement to support resolution. The requirement promotes equal treatment between EU and third-country liability holders and contributes to a firm's resolvability. The requirement also offers legal clarity to investors, creditors, counterparties, customers and depositors about the order in which they will absorb losses. This in turn enables speed and transparency in resolution and is in line with the Key Attributes<sup>1</sup> and the FSB Principles for Cross-Border Effectiveness of Resolution Actions.<sup>2</sup>

2.8 Appendix 1 puts forward draft amendments to PRA rules to cover impracticability. The PRA's expectations with regard to these proposals are set out in the draft supervisory statement in Appendix 2.

### **3 The Regulatory Technical Standards on contractual recognition**

3.1 This chapter sets out the PRA's proposals to amend the Contractual Recognition of Bail-In Part of the PRA Rulebook in order to ensure consistency with the final draft EBA RTS on the contractual recognition of bail-in.<sup>3</sup>

3.2 The draft EBA RTS further determine the list of liabilities that are excluded from the contractual recognition requirement and specify the contents of the required contractual term. The RTS are currently in final draft form. Once adopted by the European Commission, the RTS will be directly applicable in the United Kingdom as an EU regulation and will have precedence over PRA rules. The proposed amendments to the PRA rules have been formulated in light of the draft RTS and if there are changes to the final text of the RTS, we would anticipate making any necessary consequential amendments to the PRA rules at the point of finalisation. BRRD firms should ensure that they comply with the RTS in the first instance. They should refer to the PRA rules as well as to the RTS to ensure compliance with the contractual recognition requirement.

3.3 The PRA has identified three instances where the PRA Rulebook is not fully consistent with the draft EBA RTS and proposes to address these inconsistencies through the amendments set out below. The amendments cover the treatment of secured liabilities, the concept of material amendments and the notion of 'created'.

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1 'Key Attributes of Effective Resolution Regimes for Financial Institutions', Financial Stability Board, October 2014; [www.financialstabilityboard.org/2014/10/r\\_141015/](http://www.financialstabilityboard.org/2014/10/r_141015/).

2 'Principles for Cross-Border Effectiveness of Resolution Actions', Financial Stability Board, 3 November 2015; [www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf](http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf).

3 Final report EBA/RTS/2015/06 on the Draft Regulatory Technical Standards on the contractual recognition of write-down and conversion powers under Article 55(3) of Directive 2014/59/EU, dated 3 July 2015: [www.eba.europa.eu/documents/10180/1132911/EBA-RTS-2015-06+RTS+on+Contractual+Recognition+of+Bail-in.pdf](http://www.eba.europa.eu/documents/10180/1132911/EBA-RTS-2015-06+RTS+on+Contractual+Recognition+of+Bail-in.pdf).

## Secured liabilities

3.4 The PRA proposes to require the inclusion of contractual recognition language in liabilities which are not fully secured when created. It also proposes the inclusion of contractual recognition language into liabilities which are fully secured but not governed by contractual terms that oblige the debtor to maintain full collateralisation at all times, in accordance with regulatory requirements under EU law or equivalent third-country law. The PRA intends the amended rule to apply from 1 July 2016.

## Material amendments

3.5 The PRA proposes to require the inclusion of contractual recognition language in contracts governing debt instruments issued on or before 19 February 2015 and in contracts governing liabilities created before 31 December 2015, but materially amended after 30 June 2016. A material amendment is one which affects the substantive rights and obligations of a party to a relevant agreement.<sup>1</sup>

## Created

3.6 The PRA proposes to replace the reference in the rules to liabilities 'arising' after a certain date to liabilities 'created' after the respective date. The proposal would ensure consistency of language with the draft EBA RTS and provide greater clarity to BRRD firms about the liabilities in scope of the requirement.

## 4 Approach to supervision

4.1 The PRA and the Bank of England expect to use a combination of continuous supervisory assessment and, if appropriate, powers to require removal of impediments to resolvability to monitor BRRD firms and ensure compliance with the contractual recognition requirement.

4.2 The PRA will supervise and enforce the contractual recognition requirement in a proportionate, judgement-based and risk-based manner, as it does with all other requirements, and as set out in the 'PRA's approach to banking supervision' and in the 'PRA's approach to enforcement'.<sup>2</sup>

4.3 In order to inform the PRA's approach, in particular with regard to certain operational liability contracts, the PRA will work with the Bank of England as resolution authority to assess the impact on resolvability of not including contractual recognition language in specific contracts, or types of contracts. The assessment will consider a range of factors, including the monetary value and the legal nature of the liability, taking into account the implications of a departure from the *pari passu* principle and its impact on the creditor hierarchy. The assessment would also include whether liabilities in aggregate would have a significant impact on the BRRD firm's resolvability.

4.4 The PRA and the Bank of England will discuss with BRRD firms progress on the inclusion of the contractual recognition language as part of the regular update of firm resolution plans. BRRD firms will have the opportunity to indicate any difficulties encountered and steps they intend to take to ensure compliance as part of their ongoing discussions with the PRA and the

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1 The RTS provides examples of non-material amendments. They include changes of signatory contact details, typographical changes (aimed at correcting drafting errors) and automatic adjustment of interest rates.

2 'The PRA's approach to Banking Supervision'; [www.bankofengland.co.uk/publications/Pages/other/prasupervisoryapproach.aspx](http://www.bankofengland.co.uk/publications/Pages/other/prasupervisoryapproach.aspx); PRA Statement of Policy 'The PRA's approach to enforcement: statutory statements of policy and procedure'; April 2013; [www.bankofengland.co.uk/prasupervision/regulatoryaction/enforcement.aspx](http://www.bankofengland.co.uk/prasupervision/regulatoryaction/enforcement.aspx).

Bank of England. Neither the PRA nor the Bank of England will approve firms' judgements of impracticability.

## 5 The PRA's statutory obligations

5.1 The PRA may make rules where these appear to be necessary or expedient for the purposes of advancing the PRA's statutory objectives under the Financial Service and Markets Act 2000 (FSMA) to promote the safety and soundness of PRA-authorized firms.<sup>1</sup> These proposals advance the PRA's general objective by improving the effectiveness of the bail-in tool in a cross-border resolution. The proposals contribute to making resolution more credible, thus reducing the adverse effect that the resolution of a PRA-authorized person could have on the stability of the United Kingdom's financial system.

5.2 The PRA must also assess the costs and benefits of proposals and have regard to the regulatory principles as set out in FSMA, the most relevant being the proportionality of the burden on affected firms to the expected prudential benefit, considered in general terms; the desirability where appropriate of the PRA exercising its functions in a way that recognises differences in the nature and objectives of businesses carried on by different firms; the desirability of sustainable medium and long-term growth in the United Kingdom economy; and the principle of regulatory transparency. The PRA considers the proposals in this CP to be compatible with the regulatory principles.

5.3 In addition, when consulting on draft rules, the PRA is required to consider the impact on mutuals. The PRA also has a duty to facilitate effective competition as a secondary objective subordinate to its general safety and soundness objective. Finally, the PRA must consider the equality and diversity impact of its proposals. The PRA's assessment of these obligations is set out below.

### Cost benefit and competition analysis

5.4 This section sets out an analysis of the costs and benefits of the proposed amendments to PRA rules.

5.5 The markets within which the affected BRRD firms operate include those associated with credit intermediation (eg retail and commercial lending), as well as wholesale market activity (eg investment banking) and payments services.

5.6 The proposed amendments, intended to apply from 1 July 2016, are compared to the baseline of current PRA rules without the modification by consent. This is due to the fact that the modification by consent, which BRRD firms can benefit from as of 1 January 2016, expires on 30 June 2016.

5.7 Relative to the baseline, the proposed impracticability amendment would allow BRRD firms to come to a reasoned view in certain circumstances that compliance with the contractual recognition requirement is impracticable and not include the recognition language.

5.8 The amendments proposed in line with the RTS would broaden the range of liabilities in scope of the rule and ensure compliance with the RTS.

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1 See s.2B and s.137G FSMA.

### Cost benefit analysis

5.9 Taken jointly, the amendments strengthen the commitment of the PRA and the Bank of England to effective cross-border resolutions and to a well-functioning bail-in tool. The amendments require BRRD firms to include contractual recognition language in a broad range of contracts, while allowing firms to invoke impracticability in instances where the inclusion of such language is genuinely impracticable.

#### *Benefits*

5.10 The impracticability consideration ensures that when faced with genuine impracticability, BRRD firms do not have to choose between either being in breach of regulatory requirements or discontinuing business activities. The consideration would also apply to the liabilities brought in scope of the rule by the RTS amendments. The impracticability consideration avoids unintended spillover effects onto the wider economy. These effects could materialise, for instance, in the case of liabilities used for trade finance. The inability of a BRRD firm to amend such contracts may lead to the termination of certain trade financing activities. This in turn could impact international trade.

5.11 The RTS-driven amendments ensure consistency with the RTS and would also strengthen the effectiveness of the bail-in tool in a cross-border resolution by increasing the range of liabilities captured by the tool outside the EU. The amendments would also contribute to providing market transparency with regard to which liabilities can be subject to bail-in in the event of resolution. This transparency could help improve risk pricing and facilitate better credit risk management.

#### *Costs*

5.12 There is a risk BRRD firms could use the impracticability consideration in order not to include the contractual recognition language, even if such inclusion would be practicable. This would decrease the range of liabilities falling under the scope of the bail-in tool. It would thus weaken the effectiveness of the tool and as such represents a cost to addressing the 'too big to fail' concern.

5.13 The draft supervisory statement accompanying this CP minimises this risk by providing examples of the situations where BRRD firms could invoke impracticability. Moreover, the proposed amendments do not prevent the PRA from using its powers under s55M of FSMA. They also do not interfere with the Bank of England's powers under s3A of the Banking Act 2009 to require a firm to address impediments to resolvability.

5.14 There is also a risk that BRRD firms may deliberately decide to enter into liability contracts where impracticability applies, in order to circumvent the contractual recognition requirement. This would in turn represent a cost to addressing the 'too big to fail' concern.

5.15 However, the fact that a liability cannot count towards the minimum requirement for own funds and eligible liabilities (MREL) unless it contains the contractual recognition language, should provide incentives for BRRD firms, not to deliberately enter into contracts where the inclusion of recognition language is impracticable.

5.16 The changes to PRA rules, driven by the RTS, would entail compliance costs and contract renegotiation costs. Some BRRD firms could also experience an increase in funding costs. However, to the extent that such increase in funding costs properly reflects the probability of bail-in, this would lead to better risk pricing in the market. The PRA would actually see this as a benefit of the policy, as mentioned in 5.11.

5.17 Additionally, the inclusion of contractual recognition language for phase 2 liabilities should be anticipated by markets unless genuinely impracticable, in line with the proposals of this consultation paper. This would minimise the burden on BRRD firms.

5.18 The PRA therefore expects the benefits of the proposed policies to outweigh the costs.

#### **Impact on competition**

5.19 The RTS-driven amendments would support the effectiveness of the bail-in tool by preventing BRRD firms from issuing certain liabilities under non-EU law in order to avoid the inclusion of contractual recognition language into contracts. An effective bail-in tool in turn supports effective competition as it helps address the 'too big to fail' concern. The rule amendments also facilitate competition in the United Kingdom between BRRD firms with more domestic focused activities and those firms with more international activities.

5.20 The impracticability consideration would ensure that BRRD firms are genuinely able to comply with the contractual recognition requirement more broadly. The consideration would allow BRRD firms to continue accessing certain types of funding governed by third-country law and would not force BRRD firms to exit such markets if compliance with the contractual recognition requirement is genuinely impracticable.

5.21 The PRA therefore does not expect the proposed amendments to have a negative impact on competition.

#### **Impact on mutuals**

5.22 FSMA requires that the PRA assesses whether, in its opinion, the impact of the proposed rules on mutuals<sup>1</sup> will be significantly different from the impact on other firms.<sup>2</sup> Changes to the contractual recognition requirement will impact mutuals to the extent to which they have liabilities governed by third-country law. The size of this market for mutuals is extremely small however, as mutuals are relatively reliant on domestic deposit funding. The PRA therefore does not regard the impact of the proposed amendments on mutuals as significantly different from the impact on non-mutuals.

#### **Equality and Diversity**

5.23 The PRA may not act in an unlawfully discriminatory manner. It is required, under the Equality Act 2010,<sup>3</sup> to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions. To meet this requirement, the PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

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1 Mutuals include building societies, friendly societies and cooperatives.

2 Section 138K of FSMA.

3 Equality Act 2010, section 149(1).

## Appendices

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- 1 Draft amendments to Contractual Recognition of Bail-in Part**

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  - 2 Draft Supervisory Statement - The Contractual Recognition of Bail-in - Impracticability**

## **Appendix 1: Draft amendments to Contractual Recognition of Bail-in Part**

### **PRA RULEBOOK: CRR FIRMS AND NON-AUTHORISED PERSONS: CONTRACTUAL RECOGNITION OF BAIL-IN AMENDMENT INSTRUMENT [DATE]**

#### **Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (the PRA’s general rules);
  - (2) section 137T (general supplementary powers); and
  - (3) section 192JB (rules requiring parent undertakings to facilitate resolution).
- B. The PRA exercises the following powers in the Act to make those terms in the Glossary that are used in this instrument in rules applicable to qualifying parent undertakings:
- (1) section 192JB (rules requiring parent undertakings to facilitate resolution); and
  - (2) section 137T (general supplementary powers).
- C. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

#### **Pre-conditions to making**

- D. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

### **PRA Rulebook: CRR Firms and Non-Authorised Persons: Contractual Recognition of Bail-In Amendment Instrument [DATE]**

- E. The PRA makes the rules in the Annex to this instrument.

#### **Commencement**

- F. The Annex to this instrument comes into force on [DATE].

#### **Citation**

- G. This instrument may be cited as the PRA Rulebook: CRR Firms and Non-Authorised Persons: Contractual Recognition of Bail-In Amendment Instrument [DATE].

**By order of the Board of the Prudential Regulation Authority**  
[DATE]

## Annex

### Amendments to the Contractual Recognition of Bail-In Part

In this Annex, new text is underlined and deleted text is struck through.

#### 1 APPLICATION AND DEFINITIONS

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1.1 ...

[**Note:** The European Commission is due to adopt Regulatory Technical Standards under article 55(3) of the *BRRD* covering the contents of the contractual term required by Chapter 2. The RTS are currently in final draft form, as produced by the European Banking Authority (EBA). See <https://www.eba.europa.eu/documents/10180/1132911/EBA-RTS-2015-06+RTS+on+Contractual+Recognition+of+Bail-in.pdf>]

1.2 In this Part, the following definitions shall apply:

*debt instrument*

means any form of transferable debt security or instrument, whether registered or bearer, including commercial paper, bills of exchange, bankers acceptances, certificates of deposit and bonds, including *additional tier 1 instruments* and *tier 2 instruments*.

...

*excluded liability*

~~has the meaning given in section 48B(7A)(a) of the Banking Act 2009.~~ means any *liability* listed in section 48B(8) of the Banking Act 2009 except, in respect of *liabilities* created after 30 June 2016, a secured *liability* that, at the time at which it is created, is not a *fully secured liability*.

...

*fully secured liability*

means a *liability* which, at the time it is created, is fully secured and governed by contractual terms that oblige the debtor to maintain the *liability* fully collateralised on a continuous basis in compliance with regulatory requirements of *EU law* or of the law of a *third country* achieving effects that can be deemed equivalent to *EU law*.

...

*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 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*.



...

phase two liability

means an unsecured liability that is not a debt instrument.

...

unsecured liability

means

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

## **2 CONTRACTUAL RECOGNITION OF BAIL-IN**

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...

2.1 Except in the circumstances described in 2.1A a BRRD undertaking must include in the contract governing a liability a term by which the creditor or party to the agreement creating the liability recognises that the liability may be subject to the exercise of a power by the Bank of England to make special bail-in provision or mandatory reduction provision and agrees to be bound by any reduction of the principal or outstanding amount due or by any conversion or cancellation effected by the exercise of that power, provided that such liability is:

- (1) not an *excluded liability*;
- (2) not an *excluded deposit*;
- (3) governed by the law of a *third country*; and
- (4) ~~issued, entered into or arising after 31 December 2015~~ a liability of a type described in 2.3.

2.1A 2.1 does not apply in respect of a phase two liability where it would be impracticable for the BRRD undertaking to comply with 2.1 in respect of that phase two liability.

...

2.3 A liability in 2.1(4) is:

- (1) a liability (other than a liability under a debt instrument) created after 31 December 2015, regardless of whether it is created under an agreement entered into on or before 31 December 2015 (including under a master or framework agreement between the contracting parties governing multiple liabilities);

- (2) a liability (other than a liability under a debt instrument) created on or before 31 December 2015 if the agreement governing the liability is subject to a material amendment after 30 June 2016;
- (3) a liability under a debt instrument issued on or after 19 February 2015;
- (4) a liability under a debt instrument issued before 19 February 2015 which is subject to a material amendment after 30 June 2016.

## **Appendix 2: Draft Supervisory Statement - The Contractual Recognition of Bail-In - Impracticability**

### **1 Introduction**

1.1 This supervisory statement is relevant to Bank Recovery and Resolution Directive (BRRD) undertakings<sup>1</sup> to which the Contractual Recognition Part of the PRA Rulebook applies,<sup>2</sup> hereafter referred to as 'BRRD firms.'

1.2 The supervisory statement sets out the PRA's expectations on BRRD firms with regard to impracticability in the context of the contractual recognition requirement. The statement sets out the considerations BRRD firms could take into account when determining impracticability.

1.3 Providing clarity on the PRA's expectations in this area supports the PRA's general objective of promoting safety and soundness of firms by reducing the adverse effect that the disorderly failure of a firm can have on the United Kingdom's financial system.

### **2 Determining impracticability**

2.1 The PRA expects BRRD firms to make their own reasoned assessment with regard to impracticability in relation to phase 2 liabilities (ie unsecured liabilities in scope of the Contractual Recognition of Bail-in Part of the PRA Rulebook which are not debt instruments) and reach a view as to whether they are in compliance with the amended PRA rules. BRRD firms should be prepared to justify their view if asked by the PRA.

2.2 BRRD firms could, for instance, take the view that the inclusion of contractual recognition language is impracticable if:

- relevant third-country authorities have informed the BRRD firm in writing they will not allow it to include contractual recognition language in agreements or instruments creating liabilities governed by the law of that third country;
- it is illegal in the third country for the BRRD firm to include contractual recognition language in agreements or instruments creating liabilities governed by the laws of that third country;
- the creation of liabilities is governed by international protocols which the BRRD firm has in practice no power to amend;
- contractual terms are imposed on the BRRD firm by virtue of its membership and participation terms in non-EU bodies, whose use is necessarily on standard terms for all members and impracticable to amend bilaterally;
- the liability which would be subject to the contractual recognition requirement is contingent on a breach of the contract.

2.3 The above reasons for invoking impracticability are not exhaustive but provide examples of the considerations that could lead to a determination of impracticability.

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1 See PRA Rulebook [www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52268/19-02-2016](http://www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52268/19-02-2016).

2 See PRA Rulebook [www.prarulebook.co.uk/rulebook/Content/Part/211722/](http://www.prarulebook.co.uk/rulebook/Content/Part/211722/).

2.4 The PRA does not consider loss of competitiveness or profitability to be grounds for an impracticability judgment, as this is not in line with the policy intent of the contractual recognition requirement. The requirement promotes equal treatment between EU and third-country liability holders and contributes to an institution's resolvability. It offers legal clarity to investors, creditors, counterparties, customers and depositors about the order in which they will absorb losses. This in turn enables speed and transparency in resolution and is in line with the Financial Stability Board (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions<sup>1</sup> and the FSB Principles for Cross-Border Effectiveness of Resolution Actions.<sup>2</sup>

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1 'Key Attributes of Effective Resolution Regimes for Financial Institutions', Financial Stability Board, October 2014; [www.financialstabilityboard.org/2014/10/r\\_141015/](http://www.financialstabilityboard.org/2014/10/r_141015/).

2 'Principles for Cross-Border Effectiveness of Resolution Actions', Financial Stability Board, 3 November 2015; [www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf](http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf).