Supervisory Statement | SS7/16

The contractual recognition of bail-in: impracticability

June 2016

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

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1 Introduction

1.1 This supervisory statement is relevant to Bank Recovery and Resolution Directive (BRRD) undertakings[1] to which the Contractual Recognition Part of the PRA Rulebook applies,[2] 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.

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-

1 See PRA Rulebook www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52268/19-02-2016.
2 See PRA Rulebook www.prarulebook.co.uk/rulebook/Content/Part/211722/.

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[1] and the FSB Principles for Cross-Border Effectiveness of Resolution Actions.[2]

1 'Key Attributes of Effective Resolution Regimes for Financial Institutions', Financial Stability Board, October 2014; 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.