Dear Sirs,

Consultation on the implementation of the Bank Recovery and Resolution Directive

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.\(^1\)

The FMLC welcomes the opportunity to respond to HM Treasury's consultation, published 17 December 2015 (the "consultation document"), on proposals to strengthen and clarify the UK’s transposition of the Bank Recovery and Resolution Directive (the "BRRD").\(^2\) The proposed changes in the consultation document relate to (i) default event provisions and contractual write-down or conversion, (ii) stand-alone powers for the regulators to require the removal and replacement of directors and senior managers where there has been a significant deterioration in the financial situation of a firm, or where there are serious infringements of law or administrative irregularities, and (iii) powers for the Bank of England to act independently to resolve a UK branch of a third country institution. Provisions in respect of the proposed changes are contained in the draft Bank Recovery and Resolution Order 2016 (the "Draft BRRD Order") appended to the consultation document.

This letter draws attention to the issues of legal uncertainty that may arise from proposals in the consultation document relating to:

- contractual write-down and conversion; and
- safeguards and compensation arrangements.

Contractual write-down and conversion

The recommendation set out in section two of the consultation document (and in section 9 of the Draft BRRD Order) is a proposed legislative amendment to enable the Bank of England or HM Treasury, in a Part 1 instrument or share transfer order, to provide for default events to take effect in contracts or other agreements, or to take effect to the extent specified in the instrument or order.

\(^1\) Sonya Branch, Stephen Parker and Sean Martin took no part in the preparation or discussion of this letter and it should not be taken to represent the views of the Bank of England, HM Treasury or the Financial Conduct Authority.

\(^2\) Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms. The BRRD has been implemented in the UK by amendments to the Banking Act 2009.
This amendment is an exception to section 48Z *(Termination rights etc)* of the Banking Act 2009 which provides, among other things, that a crisis prevention measure or crisis management measure shall not trigger any event of default in any contract to which an institution under resolution, its subsidiaries or a member of the same group is a party, provided the firm continues to meet its substantive obligations under the contract.

The FMLC considers that this amendment may give rise to uncertainty by reason of the wide discretion which it confers on the Bank of England or HM Treasury to unpick the otherwise predictable disapplication of contractual provisions recognising enforcement events. Not knowing whether or not the default and cross-default provisions of a contract will apply is likely to give rise to considerable prospective uncertainty among market participants.

The FMLC would welcome criteria specifying the contracts or contractual provisions falling within the exception proposed in section 9 of the Draft BRRD Order.

**Safeguards and compensation arrangements**

Another change proposed by HM Treasury, set out in section four of the consultation document, is the extension of the compensation arrangements (including the "no creditor worse off" safeguard) that apply when the Bank of England stabilises a UK firm to any case where the Bank of England acts independently to resolve a third country branch.

HM Government proposes that the insolvency treatment against which the "no creditor worse off" compensation should be calculated is that of an insolvency where the proceeds are returned to the third country liquidator for distribution in accordance with third country insolvency law, except where this is to the serious detriment of local creditors.

The FMLC takes the view that the exception italicised above is broad and the concept unhelpfully vague. It is unclear, for instance, whether the exception will be engaged wherever the insolvency law of a third country falls short of offering creditor protections equivalent to those afforded under UK insolvency law or only where the insolvency law of a third country accords preferential treatment to creditors resident in the insolvency forum and, in consequence, UK creditors suffer detriment by comparison.

The FMLC recommends that HM Treasury consider whether this uncertainty could be resolved by further delimiting the term "serious detriment" or by offering further guidance. One possibility might be to consider an approach similar to that in Section 89H(4)(c) of the Banking Act 2009 so that the exception applies where the Bank of England or HM Treasury are satisfied that creditors (including depositors) located or payable in a European Economic Association ("EEA") State would not, by reason of being located or payable there, receive the same treatment as creditors (including depositors) who are located in the third country concerned and have similar legal rights. Another possibility might be to consider a more general approach similar to that in article 21.2, Schedule 1 of the Cross Border Insolvency Regulations 2006 (S.I. 2006/1030), so that third country insolvency treatment could be chosen only if the Bank
of England or HM Treasury was satisfied that the interests of creditors in the UK were adequately protected.\(^3\)

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely,

Joanna Perkins

FMLC Chief Executive

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\(^3\) In Article 21.2 of Schedule 1 of the Cross Border Insolvency Regulations 2006, a court is required to satisfy itself that the interests of creditors in Great Britain are adequately protected before entrusting the distribution of all or part of a debtor's assets located in Great Britain to a foreign representative or other designated person.