



## Financial Markets Law Committee (“FMLC”)

### Banking Scoping Forum

Date: Tuesday 18 June

Time: 2.00pm to 3.30pm

Location: White & Case LLP, 5 Old Broad Street, London EC2N 1DW.

#### In Attendance:

Stuart Willey (Chair)	White & Case LLP
Thomas Donegan	Shearman & Sterling (London) LLP
Charles Gray (by phone)	Sullivan & Cromwell LLP
Simon Hills	UK Finance
Suhail Khawaja	Wilmington Trust
Knox McIlwain	Cleary Gottlieb Steen & Hamilton LLP
Richard Small	Addleshaw Goddard LLP
Eleanor Hooper	FMLC

#### Guest Speakers:

Luca Amorello	Cleary Gottlieb Steen & Hamilton LLP
Ferdisha Snagg	Cleary Gottlieb Steen & Hamilton LLP

#### Regrets:

Alex Biles	Ashurst LLP
James Bresslaw	Simmons & Simmons LLP
Leland Goss	International Capital Markets Association (“ICMA”)
Mark Kalderon	Freshfields Bruckhaus Deringer LLP
Amy Kennedy	Gibson, Dunn & Crutcher UK LLP
Dorothy Livingston	Herbert Smith Freehills LLP
Monica Sah	Clifford Chance LLP
Mitja Siraj	FIA

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## Minutes:

### 1. Introductions

- 1.1. Stuart Willey opened the meeting and members introduced themselves.

### 2. Administration: FMLC in numbers (Eleanor Hooper)

- 2.1. Eleanor Hooper updated the members with the work undertaken and issues of legal uncertainty being considered by the other FMLC Scoping Forums and Working Groups.

### 3. Issues of uncertainty arising under the revised Capital Requirements Directive (“CRDV”)<sup>1</sup>, Capital Requirements Regulation<sup>2</sup> (“CRR2”) and revised Bank Recovery and Resolution Directive (“BRRD2”)<sup>3</sup>, including the FSB’s prospective review of the TLAC standards (Knox McIlwain, Luca Amorello and Ferdisha Snagg)

- 3.1. Ferdisha Snagg set out of the current status of the various measures. The final text of the CRDV, CRR2 and BRRD2 proposals was published in the Official Journal on 7 June 2019 and entered into force on 27 June. One of the aims of the legislation is to implement and harmonise the application of the FSB’s total loss absorbing capacity (“TLAC”) requirements for EU Global Systemically Important Banks (“G-SIBs”). The FSB TLAC requirements for G-SIBs are being phased in from 1 January 2019 to 1 January 2022.
- 3.2. Ferdisha Snagg observed that the implementation of the TLAC regime under CRR2 and the minimum requirement for own funds and eligible liabilities (“MREL”) regime under BRRD2 has some interesting implications. The regime imposes requirements for internal, as well as external, loss absorbing capacity. In addition material subsidiaries of non-EU G-SIBs that are not resolution entities are required to meet internal MREL requirements (90% of the requirement that would have applied under CRR2 had the entity been a resolution entity).
- 3.3. Ferdisha Snagg highlighted some high level issues which may be of interest under CRDV/CRR2.

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<sup>1</sup> Directive (EU) 2019/878 amending the Capital Requirements Directive IV as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measure and powers and capital conservation measures.

<sup>2</sup> Regulation (EU) 2019/876 amending the Capital Requirements Regulation as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements.

<sup>3</sup> Directive (EU) 2019/879 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC.

- 3.3.1. Remuneration. The proportionality principle is retained but cannot be relied upon to waive the application of remuneration requirements, such as the bonus cap. However, certain requirements do not apply to smaller institutions or lower-income staff. The remuneration requirements now include a requirement for institutions' remuneration policy to be gender-neutral. Further regulatory technical standards (RTS) are awaited to clarify what this will mean in practice and whether further measures may be mandated aimed at addressing the gender pay gap.
- 3.3.2. Consolidation. In general, subsidiaries which are subject to Alternative Investment Fund Managers Directive (AIFMD) remuneration requirements (or other sector-specific remuneration requirements) will not be subject to the CRDV remuneration requirements. Members commented that this was a helpful development.
- 3.3.3. Intermediate parent undertaking rules. There is a requirement for third-country groups having significant activities (two or more institutions and at least EUR 40 billion of assets) in the EU to have an EU intermediate parent undertaking. In the UK from 1 January 2019, large banks are required to separate core retail banking from investment banking under the ring-fencing requirements of the Financial Services (Banking Reform) Act 2013. It is not clear how these requirements will play out in practice and fit with the CRR2 provisions.
- 3.3.4. Large exposure framework. The overall exposure limit of a firm to a single counterparty or a group of connected counterparties is now set lower (at 15%) for a G-SIB's exposure to exposure to another G-SIB.
- 3.3.5. In January 2019 the Council of the EU agreed to develop a new prudential regulation framework for investment firms. More detail on this proposal is anticipated.

3.4. Knox McIlwain and Luca Amorello identified four potential areas of uncertainty which the forum might wish to consider further.

- 3.4.1. Use of the terms "resolution entity" and "resolution group" for non-EU groups. These terms relate (respectively) to entities organised in the EU that would be subject to EU resolution powers in accordance with the resolution strategy for the group, and to their subsidiaries. BRRD2 (Article 12) states

that the resolution plan “shall identify” the resolution entities and resolution groups for each group. It is not clear how this requirement applies where a third-country group has a single point of entry (“SPOE”) resolution strategy. As a related point, there is some ambiguity in the application of MREL provisions on a consolidated basis when the relevant criteria are applied to non-EU headquartered groups. The relevant criteria reference the “resolution entity” and the “resolution group” (defined in BRRD2) and the calculation is based on the consolidated situation of the EU parent institution. Assuming SPOE is recognised, for a non-EU headquartered group there may be no entity organised in the EU which is subject to the powers of the relevant authorities.

- 3.4.2. Tier 1 and Tier 2 instruments eligibility requirements (CRR2 Articles 52 and 63). The qualifying criteria have changed from the “purchase” to the “acquisition of ownership” of an instrument not being funded by the institution. This change may enlarge the scope of the exception. More guidance on the meaning of ownership in the context of indirect issuances may be welcome.
- 3.4.3. The definition of Tier 2 instruments (Article 63 CRR2) no longer refers to subordinated loans, just ‘capital instruments’. It is unclear whether this change is substantive and whether ‘capital instruments’ includes subordinated loans or whether they are excluded.
- 3.4.4. Practical interpretation of the “Write down or conversion of capital instruments and eligible liabilities” under Article 59 BRRD2. The text of Article 59 was changed to refer to eligible liabilities and the power may be exercised independently of resolution with respect to internal MREL. The scope and practical application of Article 59 in relation to MREL, the bail-in tool and resolution generally is unclear. It is important for the market to have a clear understanding of how the procedures operate and any potential implications for holders of MREL. Members suggested that the Banking Scoping Forum could consider this issue further.

#### **4. Plenary discussion on recent and anticipated legislation and developments in the banking sector- potential areas of focus for future meetings (led by Stuart Willey)**

- 4.1. Stuart Willey led a discussion on recent and anticipated legislation and developments in the banking sector and explained that purpose of this discussion is for members to identify potential areas of focus and recommendations for work for the Banking Scoping Forum.
- 4.2. A member raised the topic of operational resilience and continuity during bank resolution, following the recent launch of a report by TheCityUK, “Operational resilience in financial services: time to act” on 5 June 2019 and the discussion paper issued in July 2018 by the Bank of England (BoE), Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) “[Building the UK financial sector’s operational resilience](#)”. Banks are under scrutiny to ensure that their outsourcing arrangements are sufficiently resilient with an emphasis on the continuity of important business services. This extends to contractual arrangements with third parties, for example including obligations to support the transition to a new service provider because the contract involves a critical service for a bank.
- 4.3. A member gave an example of a client which was asked by the PRA to demonstrate its preparedness for operational continuity in resolution and specifically that it would have access to ring-fenced funds for the sole purpose of paying providers of key services. Members discussed that it can be complex and expensive for banks to ring-fence assets for this purpose to ensure that they would always be available. A member commented that under the US approach using single point of entry resolution this is less of a problem as operating subsidiaries continue unaffected and ring-fencing is limited.
- 4.4. Members agreed that there are some evolving issues in this area which the Banking Scoping Forum could consider further.

## **5. Next Steps**

- 5.1. Stuart Willey agreed to prepare a short briefing note on selected issues raised in the discussion on BRRD2, with input from Knox McIlwain, Luca Amorello and Ferdisha Snagg, for the consideration of the FMLC Committee.

## **6. Any other business**

- 6.1. No other business was raised.

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