



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

The Rt Hon. Lord Boswell of Aynho
Chairman
European Union Committee
Committee Office
House of Lords
London
SW1A 0PW

27 July 2013

EM 11066/12: Bank Recovery and Resolution Directive (BRRD)

Thank you for your letter of 17 July on the Bank Recovery and Resolution Directive (BRRD). You raised a number of questions regarding the General Approach agreed at the Economic and Financial Affairs Council meeting of 26-27 June, some of which were discussed when I appeared before the Sub-Committee on Tuesday 23 July.

Lessons learnt from Cyprus and the treatment of depositors

Recent events in Cyprus highlighted again that EU Member States need a robust framework for bank recovery and resolution. As I set out in my previous letter, dated 9 July, we agreed to the package having achieved a number of favourable outcomes for the UK.

Our consistent aim has been to agree a common set of credible tools, including a useable bail-in tool, to increase the resilience of banks and, where necessary, manage their failure in an orderly way. The General Approach provides a common set of recovery and resolution tools, including a credible bail-in regime. These tools should preserve the continuity of critical functions and avoid damaging financial stability.

Under the General Approach text, deposits covered by the Deposit Guarantee Scheme (the FSCS in the UK) will be permanently excluded from bail-in. Moreover, insured depositors and by extension the DGS will have "super-preference" in the insolvency hierarchy, which will limit the likelihood that the DGS will be called upon to bear losses in the event of a failure of a deposit-taker and so offers further protection to taxpayers. This is in line with the Vickers recommendations.



Flexibility and level playing field of the single market

Your letter asked about the possibility of a two tier recovery and resolution system, whereby some Member States would bail-out, while others bail-in. The agreement seeks to protect the level playing field by outlining clear rules for when resolution financing arrangements, or alternative financing arrangements, can be used which all countries must adhere to.

The European Commission will also continue to have a strong role in protecting the single market through the State-aid framework. For example, you may have seen the European Commission recently published new temporary State-aid guidelines that impose tougher burden sharing provisions.¹ Robust State aid principles, including imposing private sector burden sharing conditions prior to any disbursement of State aid, will create an environment which will help ensure a level-playing field across the single market.

Single Resolution Mechanism (SRM)

Your letter raises questions regarding the recent European Commission proposal for a Single Resolution Mechanism.² I will be sending you an Explanatory Memorandum on this proposal shortly but we note that the role for the European Banking Authority will continue to be considered carefully in the context of the negotiations of both the BRRD and the SRM proposal.

Funding impact on banks

We have been working to ensure that all banks are subject to normal competitive market forces. They should be able to fail safely, without the need for taxpayer support. This means that creditors must expect to share the burden if capital levels are insufficient to cover losses.

A necessary consequence of reducing the size of any perceived implicit guarantee is that these costs would be imposed on banks. By exposing creditors to these costs, bail-in helps ensure that they do not obtain financial rewards without being appropriately exposed to the corresponding risks.

¹ http://europa.eu/rapid/press-release_IP-13-672_en.htm

² <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0520:FIN:EN:PDF>



To manage the potential effects on bank funding costs any transition period needs to be managed so that market participants can appropriately 'price in' the risk of the bail-in tool being used. The fact that there is a common framework across the EU should minimise any competitive distortions.

Bail-in implementation date

The Council General Approach text does not require the introduction of the bail-in tool until four years after the entry into force of the Directive (currently expected to be 2018). However, Member States may introduce the bail-in power earlier, alongside the rest of the proposals (currently expected to be 2015), if they choose. The European Parliament version of the text requires the bail-in provisions to be implemented by 1 July 2016 at the latest, so it is not yet clear what the final implementation date will be.

In addition, it is worth pointing out that the provisions relating to write down of capital instruments (Articles 51-55) will apply from the entry into force of the Directive (currently expected to be 2015). This will ensure that all regulatory capital instruments are fully able to bear losses.

I am copying this letter to William Cash MP, Chairman of the House of Commons European Scrutiny Committee; and copying this letter to Sarah Davies, Clerk to the Commons Committee; Jake Vaughan, Clerk to the Lords Committee; Stuart Stoner, Clerk to Lords Sub-Committee A; Les Saunders, Cabinet Office; Kunal Patel and Thomas Kenny, HM Treasury.

Yours ever

Greg

GREG CLARK MP
FINANCIAL SECRETARY TO THE TREASURY

