

<b>Title:</b> Implementing secondary legislation to apply bail-in effectively to building societies and apply safeguards for compensation and restriction of special bail-in provision <b>IA No:</b> <b>Lead department or agency:</b> HM Treasury <b>Other departments or agencies:</b> Department for Business, Innovation and Skills	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 19/08/2014		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> EU		
	<b>Type of measure:</b> Secondary legislation		
<b>Contact for enquiries:</b> BRRD.Transposition@hmtreasury.gsi.gov.uk			
<b>Summary: Intervention and Options</b>		<b>RPC Opinion:</b> GREEN	

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?
£0	£0	£0	No
			NA

**What is the problem under consideration? Why is government intervention necessary?**

The Financial Services (Banking Reform) Act 2013 amended the Banking Act 2009 to introduce a new stabilisation option – the bail-in option, which allows the Bank of England to cancel shares, write down debt and convert debt to equity in a failing bank in order to recapitalise it. The bail-in tool is also required by the Bank Recovery and Resolution Directive (BRRD). The BRRD requires that Member States put in place adequate safeguards to protect creditors subject to bail-in. The bail-in power already extends to building societies, as required by the BRRD. However, given their different legal form, some modifications are necessary to ensure the powers can be used effectively to resolve a failing building society.

**What are the policy objectives and the intended effects?**

The policy objectives are to ensure the UK authorities have a full, credible bail-in regime at their disposal that can apply to both banks and building societies, and is consistent with EU requirements. The safeguards will be delivered through the Mandatory Compensation Arrangement Order, which ensures that compensation is paid to any creditors left in worse position through bail-in than they would have been under normal insolvency proceedings; and the Restriction of Bail-in Order, which ensures that contractual rights such as set-off and netting are protected under bail-in. The Building Societies Bail-in Order ensures the bail-in tool can be used effectively on building societies, given the differences in legal form and business model

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

Option 1: Implement the safeguards for compensation following bail-in and the restriction of its use on certain liabilities, as required by the BRRD, to a transposition timeline consistent with broader transposition of the BRRD (i.e. 1 January 2015). Do not implement measures around the application of bail-in to building societies as they are already within scope for the domestic primary legislation.

Option 2: Implement the safeguards for compensation following bail-in and the restriction of its use on certain liabilities, as required by the BRRD, to a transposition timeline consistent with broader transposition of the BRRD (i.e. 1 January 2015). And introduce measures to ensure the effective application of bail-in to building societies (preferred option)

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 01/2019					
Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	<b>Micro</b> No	<b>&lt; 20</b> No	<b>Small</b> Yes	<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			<b>Traded:</b> N/A	<b>Non-traded:</b> N/A	

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

Signed by the responsible Minister: \_\_\_\_\_ **Andrea Leadsom** \_\_\_\_\_ Date: 21/11/2014

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Implement the safeguards, consistent with BRRD requirements by 1 January 2015. Do not implement any further measures to ensure bail-in may be applied to building societies.

## FULL ECONOMIC ASSESSMENT

Price Base Year N/A	PV Base Year N/A	Time Period Years N/A	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0	0	0
High	0	0	0
Best Estimate	0	0	0

### Description and scale of key monetised costs by 'main affected groups'

The safeguards are not expected to result in any cost to business as they restrict the authorities' use of the bail-in tool and provide further clarity to the market on how they will be used. Not implementing any specific building society bail-in measures will not increase cost over what has already been estimated. However, it may limit the ability for the authorities to use the bail-in tool on building societies. This may mean that public funds are required if a building society fails.

### Other key non-monetised costs by 'main affected groups'

There may be some cost to the Government in providing compensation to affected creditors. However this will vary in each individual case, and the bail-in can be carried out in such a way as to limit any compensation liability. The potential cost of any compensation cannot therefore be estimated. Relying on the primary legislation to bail-in a building society may mean that the UKs regime is out of step with the rest of the EU, and may cause market uncertainty over the tools use.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			
High			
Best Estimate	See Text	See Text	See Text

### Description and scale of key monetised benefits by 'main affected groups'

The benefits of these measures are hard to quantify as they would only be realised if a bank or building society were to fail. See text for further details.

### Other key non-monetised benefits by 'main affected groups'

The introduction of the safeguards will provide creditors of banks and building societies with a greater degree of certainty about their treatment in the event of a bail-in. This will allow them to better assess the risk of their investment, make informed investment decisions and to price them accordingly.

### Key assumptions/sensitivities/risks

Discount rate (%)

N/A

The extent to which banks pass through the costs of the policy to consumers and the subsequent impact to GDP. That the long run driver of tax receipts is GDP, so exchequer costs are directly related to the impact on GDP. The modelling has been done on a static basis and has not taken behavioural change into account

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:	In scope of OIIO?	Measure qualifies as
Costs: 0	No	IN
Benefits: See Text		
Net: N/A		

# Summary: Analysis & Evidence

# Policy Option 2

**Description:** Implement the safeguards, consistent with BRRD requirements by 1 January 2015. Implement further measures to ensure bail-in may be applied to building societies more effectively.

## FULL ECONOMIC ASSESSMENT

Price Base Year N/A	PV Base Year N/A	Time Period Years N/A	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0	0	0
High	0	0	0
Best Estimate	0	0	0

### Description and scale of key monetised costs by 'main affected groups'

The safeguards are not expected to have any cost to business as they restrict the authorities' use of the bail-in tool and provide further clarity to the market on how they will be used. Implementing specific building society bail-in measures will ensure that the Bank of England can more effectively use the bail-in tool on building societies. This is not expected to have any material cost to business over those already outlined in the main Impact Assessment on transposition of the BRRD

### Other key non-monetised costs by 'main affected groups'

There may be some cost to the Government in providing compensation to affected creditors. However this will vary in each individual case, and the bail-in can be carried out in such a way as to limit any compensation liability.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			
High			
Best Estimate	See Text	See Text	See Text

### Description and scale of key monetised benefits by 'main affected groups'

It is not possible to quantify the benefits of this option as they are largely contingent on the event of the bail-in tool being used on a bank or building society. The probability of a bank or building society entering severe financial difficulties cannot be estimated with any real degree of accuracy. Please see text for further details

### Other key non-monetised benefits by 'main affected groups'

The introduction of the safeguards will provide creditors of banks and building societies with a greater degree of certainty about their treatment in the event of a bail-in. This will allow them to better assess the risk of their investment, make informed investment decisions and to price accordingly. The Building Society Bail-in Order will provide building societies and their creditors with further information on how the bail-in powers would be used in relation to a failing building society

<b>Key assumptions/sensitivities/risks</b>	<b>Discount rate (%)</b>	N/A
The extent to which banks pass through the costs of the policy to consumers and the subsequent impact to GDP. That the long run driver of tax receipts is GDP, so exchequer costs are directly related to the impact on GDP. The modelling has been done on a static basis and has not taken behavioural change into account		

## BUSINESS ASSESSMENT (Option 2)

<b>Direct impact on business (Equivalent Annual) £m:</b>	<b>In scope of OIOO?</b>	<b>Measure qualifies as</b>
Costs: 0	No	IN
Benefits: See Text		
Net: N/A		

# Evidence Base

## Introduction

1. The Financial Services (Banking Reform) Act 2013 (the 'Banking Reform Act') added a bail-in tool to the Special Resolution Regime (SRR) through amendments to the Banking Act 2009. The bail-in option allows the Bank of England to resolve a bank or building society that is failing or likely to fail by writing down or cancelling certain debt liabilities and/or converting debt into equity. This has the effect of recapitalising the firm and allows it to remain a going concern while actions are taken to address the issues which caused the failure. It also allows the bank or building society to maintain their critical economic functions, such as deposit taking and lending, reducing the disruption and risk of contagion to the wider financial sector. During the financial crisis, the Government was forced to bail-out some banks at huge expense to the taxpayer and shared to some extent with the banking industry. The bail-in tool provides a viable alternative, facilitating the resolution of a failing bank or building society without the need to use public funds. The Government no longer intends to commence these powers ahead of the transposition timeframe of the Bank Recovery and Resolution Directive (BRRD). However, the measures discussed in this Impact Assessment are also required under the BRRD.
2. The Independent Commission on Banking (ICB) recommended that the UK introduce bail-in powers<sup>1</sup> and the Government accepted this recommendation, recognising that bail-in is a critical tool in ensuring that shareholders and creditors of failing banks bear the costs of failure, not the taxpayer, and to put an end to the implicit guarantee large banks are seen to benefit from. However, at that stage the Government indicated its intention to introduce bail-in powers through the European process, given the advantages of introducing a tool that was consistent with other jurisdictions and in order to avoid the need to make significant changes to UK legislation when implementing the EU Directive.
3. However, in October 2013, in line with the recommendation from the Parliamentary Commission on Banking Standards (PCBS), the Government announced its intention to introduce domestic legislation giving the Bank of England bail-in powers. The PCBS recommended that the UK introduce bail-in powers which could be used if the EU proposals were delayed or inadequate<sup>2</sup>. These powers were introduced through the Financial Services (Banking Reform) Act 2013 and have not yet been commenced. The costs and benefits associated with this domestic legislation were estimated in an Impact Assessment<sup>3</sup> (the primary IA) on the assumption that they would be in place for approximately one year, before having to be amended as part of transposition of the BRRD in order to comply with EU law. Costs and benefits associated with the domestic legislation therefore accrue from 18 December 2013.
4. The BRRD must be applied in the UK by 1 January 2015, but flexibility is given to delay the commencement of just the bail-in provisions in the Directive until 1 January 2016. One of the measures discussed in this IA (the Building Societies Bail-in Order) is primarily intended to ensure that the bail-in provisions can be applied affectively to building societies and hence, it

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<sup>1</sup> <https://hmt-sanctions.s3.amazonaws.com/ICB%20final%20report/ICB%2520Final%2520Report%5B1%5D.pdf>

<sup>2</sup> <http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpebs/98/98.pdf>, page 101

<sup>3</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/271121/Bail-in\\_IA.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/271121/Bail-in_IA.pdf)

could be delayed until 1 January 2016. The other two Orders must be applied from 1 January 2015. The additional flexibility was provided due to the novel nature of bail-in powers and the need for some Member States and their banking sector to prepare for its introduction. However, the Government does not intend to use this flexibility and plans to implement the bail-in provisions (including the building society measures) by 1 January 2015. Since the UK already has a bail-in tool in domestic legislation the costs associated with the domestic bail-in provision would continue to accrue over the period of 1 January 2015 to 1 January 2016, meaning that delaying the implementation of the EU Directive would not significantly reduce the overall impact on bank funding costs. The choice is therefore between an additional year of the domestic bail-in legislation and its associated costs, or implementing the BRRD bail-in provisions one year early and incurring the costs of early implementation. The Government believes it is preferable to implement the BRRD bail-in provisions early, in order for the legislation to reflect the BRRD agreement at the earliest opportunity, rather than to have to change domestic legislation in January 2016. In response to the consultation “Bail-in powers Implementation<sup>4</sup>”, industry strongly indicated they felt it was important for UK legislation to be fully consistent with BRRD requirements, since to do otherwise would create uncertainty for businesses.

5. For the effective application of the bail-in tool, and to give the UK authorities a full bail-in regime, three pieces of legislation are required. These proposals are consistent with the requirements in the BRRD and therefore the Government intends to implement these measures to a timetable consistent with BRRD transposition. The three proposed Orders are:

- Building Societies (Bail-in) Order
- The Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations
- The Banking Act 2009 (Restriction of Special Bail-in Provision etc.) Order

All three orders are intended to be transposed by 1 January 2015. This is required by BRRD except for the Building Societies (Bail-in) Order, which, as discussed above, the Government is proposing to implement 1 year ahead of the deadline for implementation.

## **Problem Under Consideration and Rationale for Intervention**

6. Building societies are within scope of the bail-powers by virtue of the primary legislation. Section 17(2) of the Financial Services (Banking Reform) Act 2013 states that “The Treasury may by order make any provision they consider appropriate in consequence of the application to building societies”. This order may, in particular transfer the building society to, or convert the building society into a public limited company for the purposes of a bail-in. This would result in a building society being demutualised. This is consistent with the BRRD which requires Member States to ensure that the bail-in tool may be applied to all institutions within the scope of the BRRD (which includes building societies) and requires that they have the power to change the legal form of the institution if necessary to ensure that this is the case. The Order does not, therefore, extend the scope of the tool, but makes the necessary

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<sup>4</sup><https://www.gov.uk/government/consultations/bail-in-powers-implementation-including-draft-secondary-legislation/bail-in-powers-implementation>

modifications to ensure that the tool can be applied effectively to a building society in practice. Without these modifications, there is likely to be significant market uncertainty regarding the application of the bail-in powers to a building society, which this Order seeks to avoid.

7. The Banking Act 2009 (Mandatory Compensation Arrangements) Regulations are made under section 60A of the Banking Act 2009, as amended by the Financial Services (Banking Reform) Act 2013. Section 60B of the Act requires that, when making regulations, the Treasury has regard to the desirability of ensuring that pre-resolution shareholders and creditors of a bank do not receive less favourable treatment than they would have received had the bank entered insolvency immediately before the initial resolution instrument takes effect. The draft Regulations are intended to ensure that this principle is followed. Following bail-in, a resolution-specific compensation order must be made. The Regulations provide for provisions that must be included in all such resolution-specific orders, to provide upfront certainty to market participants. The Regulations provide for an assessment of how shareholders and creditors of a bank or building society are treated under bail-in and how they would have been treated had no action been taken and the firm had entered insolvency. If creditors are found to be in a worse position under bail-in than they would have been in insolvency, they are entitled to compensation equal to the difference.
8. The Banking Act 2009 (Restriction of Special Bail-in Provision) Order provides that certain financial contracts are excluded from the scope of the bail-in tool. Some financial contracts, such as those with contractual set-off and netting arrangements, benefit from a higher level of protection in insolvency. If bail-in of these contracts were not restricted appropriately, owners of these contracts are likely to suffer higher losses than they would have done in insolvency, and would therefore be entitled to compensation. To mitigate the risk of the compensation liability, and to provide holders of such contracts with a greater degree of certainty about their treatment in the event of bail-in, the Government proposes to restrict the use of bail-in powers on these financial contracts.
9. The Banking Act 2009 (Mandatory Compensation Arrangements) Regulations and Banking Act 2009 (Restriction of Special Bail-in Provision) Order are designed to fulfil requirements in the BRRD. Therefore, this IA does not consider the option of not introducing these as they are required by the BRRD, but it does assess the costs of benefits of introducing them.

### **Policy objective**

10. The policy objective is to ensure the UK authorities a full and effective bail-in regime option in the SRR, which is consistent with the requirements of the BRRD. This regime is required under the BRRD, along with other measures to establish an effective framework for the recovery and resolution of failing banks across the EU.

### **Description of Policy Options**

11. Option 1: Implement the safeguard measures for compensation and the restriction of use around bail-in to a timetable consistent with BRRD transposition (i.e. 1 January 2015). Do not implement any further provision for applying the bail-in tool to building societies. As

building societies are in scope of the primary powers, the bail-in tool can be used on a building society already without any further provision.

12. Option 2: Implement the safeguard measures for compensation and the restriction of use around bail-in to a timetable consistent with BRRD transposition (i.e. 1 January 2015). Also implement further provision to ensure the bail-in tool can be applied more effectively to building societies (this is the preferred option).

## **Costs and Benefits of Option 1**

### **Costs of Option 1**

#### **Costs of not implementing the Building Societies (Bail-in) Order**

13. Since no further modifications will be made the bail-in tool, no further costs to business are expected to arise from this measure.
14. By not specifying any further provision for the application of bail-in, there may be greater market uncertainty about how the tool would be used in practice. This could potentially be reflected by investors demanding higher premiums on debt, increasing the cost of funding for building societies. It may also be the case that the UK has a regime that, while compliant with the BRRD, is not aligned with the rest of the EU, which may cause difficulties in the case of any cross border resolutions.
15. As no new requirements will be placed upon building societies, the Government estimates that no new cost to business will arise.

#### **Costs of the Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations**

16. This Order is made under section 60A of the Banking Act 2009. The primary IA was prepared on the basis that such an Order would be in place and would reduce the overall impact of the bail-in tool by reducing the increase in banks' cost of funding caused by the introduction of a bail-in tool. The Commission's Impact Assessment for the BRRD highlighted a number of mitigating factors to the overall impact of a bail-in tool, including the "No Creditor Worse Off Principle", and indicated that such factors could reduce the overall impact by as much as 65 per cent.
17. The Order sets out provisions to ensure that when creditors of a failing bank are bailed-in, they are entitled to a fair and independent assessment of how their treatment compares to the treatment they would have received had no resolution action been taken and the firm had entered insolvency.
18. The Government and the Bank of England would also intend to use the bail-in tool (and the resolution tools) in such a way that compensation would not be required. However, any costs associated with compensating affected creditors following a bail-in are difficult to estimate as they will differ on a case by case basis and depend on the level of difference in treatment. This cost is also a contingent liability that will fall on the Government should the

bail-in tool be used on a bank or building society. These costs will also only arise if creditors choose to make a claim, they are not obliged to by the legislation.

19. This measure does not impose any further regulatory requirements or costs to business. Creditors may incur some costs in going through the independent valuer process, however these are difficult to estimate as any costs incurred would be at the discretion of the creditor. Creditors will have the option of challenging any valuation and if they did so, they would incur legal fees. However, whether to incur this cost is at their discretion, and the cost of doing so would also depend on choices they made. Therefore the Government has not attempted to estimate these costs as they do not arise directly from the introduction of the legislation. It should also be noted that if the institution is resolved as an alternative to insolvency, then the costs associated with insolvency (including the cost of the administration itself, and any legal fees incurred by the creditors) will be avoided
20. As such the Government believes there will be no private cost to business from the measure. The Order does not prescribe any new requirements to businesses and ensures that they receive compensation where necessary in line with the no creditor worse off principle

### **Costs of the Banking Act 2009 (Restriction of Special Bail-in Provision) Order**

21. This Order restricts the use of the special bail-in provision (the power to write down debt or convert debt into equity) on certain financial contracts. The approach taken is that all liabilities, except those specified in the Order, will be subject to the bail-in powers.
22. The primary IA was prepared on the basis that safeguards of this type would be provided through secondary legislation. This measure restricts the use of the bail-in tool by requiring that certain contractual rights that would be effective in insolvency will also be respected in bail-in. This reduces the impact that bail-in has on the holders of contracts subject to this safeguard, and in particular limits their maximum loss in the event of bail-in. This provides greater market certainty, which would be expected to limit the risk premium demanded by the holders of these contracts. The Government expects there to be no cost to business as a result of this measure as it restricts the use of the bail-in tool and gives creditors a greater degree of certainty of how they will be treated in a bail-in.

### **Total Cost of Option 1**

23. The Government estimates that this option would not incur any further cost to business since the safeguards give comfort to the market on how the tool is most likely to be used. And since there would be no modifications to the bail-in tool with respect to building societies, the cost of this measure is also estimated to be zero (as no action has been taken beyond the introduction of the bail-in powers themselves, the costs and benefits of which are estimated in the primary IA). This option represents the baseline scenario.

### **Benefits of Option 1**

### **Benefits of not implementing the Building Societies Bail-in Order**



24. Benefits of this option are limited, as without specific provision detailing the application of bail-in to building societies, it is likely to be hard to exercise the powers in practice.

### **Benefits of the Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations**

25. This measure will ensure that creditors that are affected by bail-in are entitled to a fair and independent valuation of the actual treatment that they received in bail-in, and their hypothetical treatment if the firm had gone into insolvency – i.e. what their recoveries would have been. If their actual treatment is worse than the treatment they would have received had no resolution action been taken and the firm had instead entered insolvency, then compensation equal to the difference will be paid. This promotes wider financial stability and provides market participants with a degree of confidence and certainty that they will receive fair treatment. The Commission also suggested in its IA for the BRRD that factors such as No Creditor Worse Off could mitigate the impact of bail-in by as much as 65 per cent<sup>5</sup>

### **Benefits of the Banking Act 2009 (Restriction of Special Bail-in Provision) Order**

26. There are certain financial contracts that benefit from additional protections in insolvency – for example, contracts which include set off and netting rights. If they were bailed-in in a way which did not respect these rights, then this may give rise to a significant compensation claim from creditors. Restricting the use of bail-in on these type of contracts would mitigate this risk and reduce the contingent compensation liability as it would ensure that these rights are respected. This safeguard would also give market participants greater confidence on how the bail-in tool would be used in practice and allow them to estimate their maximum potential loss in the event of bail-in – which, as a result of these safeguards, will be equal to the loss they would experience if the institution entered insolvency.

### **Total Benefits of Option 1**

27. The benefit of option 1 is that implementing the safeguards for compensation and the treatment of certain financial contracts during a bail-in will give market participants confidence in how the bail-in tool is likely to be used and allow them to make more accurate predictions about their treatment in a bail-in. This will increase financial stability as there is less uncertainty. It puts in place a backstop that ensures that creditors will not be left in a worse position than they would have been under normal insolvency proceedings.

### **Costs and Benefits of Option 2**

#### **Costs and of Option 2**

#### **Costs of the Building Societies (Bail-in) Order**

28. The total cost for bail-in was estimated in the BRRD IA as between £35.2m and £294.9m annually, including for building societies. However, the Government is of the view that this is

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<sup>5</sup> EU Commission Impact Assessment. Page 48 [http://ec.europa.eu/internal\\_market/bank/docs/crisis-management/2012\\_eu\\_framework/impact\\_assessment\\_final\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/crisis-management/2012_eu_framework/impact_assessment_final_en.pdf)

a wide range, and expects the actual impact to be lower and in line with the best estimate provided in the IA for the BRRD. The BRRD IA best estimate for the impact of the bail-in tool as a whole is £96.5m per year.

29. Building societies are primarily deposit funded and only a small number issue the type of debt that would be affected. Building societies on aggregate have £0.3bn of unsecured debt maturing in 2014. Taking this a rough annual estimate and applying the same basis point impact used for banks, the Government estimates that between £0.6m and £2.6m – less than 3 per cent of the total annual cost of between £35.2m and £294.9m – is attributable to building societies. As stated above, this cost is included in the Impact Assessment for transposition of the BRRD, and is not an additional cost resulting from the Building Societies (Bail-in) Order. Under this proposal however, these costs would come into effect one year earlier than if the flexibility to delay implementation of the bail-in powers were used. The costs above represent an annual, ongoing cost for building societies and would start from January 2015. The Impact Assessment for the domestic bail-in legislation only account for costs in 2014. If this flexibility was used, the costs would still accrue in 2015 because of the domestic legislation already being in place.

30. As the UK already has a bail-in tool that can be applied to building societies, this Order does not impose any new regulation onto building societies, or anything that would further increase the cost of funding over and above that already set out in the primary IA. The Government therefore does not expect there to be any costs to business from this measure over and above what has previously been outlined.

### **Costs of the Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations and the Banking Act 2009 (Restriction of Special Bail-in Provision) Order**

31. . The costs of these measures under this option are the same as under option 1 as the BRRD requires them to be implemented by 1 January 2015.

### **Total Cost of these measures**

32. The Government believes that these measures do not place any additional regulatory burden or costs to business beyond those previously estimated in the primary IA, for the reasons explained above. Therefore, the cost of implementing these safeguards and modifying the bail-in powers to apply to building societies is estimated to be zero.

### **Benefits of Option 2**

#### **Benefits of the Building Societies (Bail-in) Order**

33. The Order will ensure that the Bank of England can use its bail-in powers effectively in the event of the failure of a building society. This provides a credible alternative to insolvency or bail-out, avoiding the adverse economic impact of the former, and the public cost of the latter. It will also provide building societies and their creditors with greater certainty about how the bail-in powers will be applied to building societies, allowing them to understand the risks they face and promoting market certainty. The Government believes that implementing

these provisions ahead of the BRRD final deadline for transposition (1 January 2016) will ensure a building society can be resolved effectively by way of bail-in, should it be required.

### **Benefits of the Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations and the Banking Act 2009 (Restriction of Special Bail-in Provision) Order**

34. The costs of these measures under this option are the same as under option 1.

#### **Total benefits of these measures**

35. These Orders will give investors and bank creditors more certainty about how they would be treated in a bail-in. This will help stabilise financial markets (since there will be less uncertainty). Without these safeguards in place, it would not be appropriate to commence the powers in the primary legislation, due to the risk of market disruption. Therefore, not implementing this secondary legislation could severely limit the Authorities' ability to deal with a failing bank. Without the modification to apply bail-in to building societies, the bail-in tool would not be as effective in resolving a failing building society, which may lead to further market disruption. These benefits are difficult to quantify and are generally only truly realised in the event of using the bail-in tool. It is the Government's belief however, that the benefits of having these provisions in place, outweigh the associated costs.

#### **Impacts on GDP**

36. The most likely channel by which GDP will be affected by these measures is through lending rates to the real economy. The increased cost of unsecured wholesale debt to banks and building societies may be fully absorbed by the firm and they may seek to reduce costs elsewhere. However, this IA assumes 100 per cent of this cost is passed on to consumers.

37. For the reasons outlined above, the Government does not expect the measures in this IA to increase costs to businesses above what has already been estimated. As costs are not expected to change, it follows that there will be no impact to GDP

#### **Impact on the Exchequer**

38. The long run driver of tax receipts is GDP. All else being equal, lower GDP would result in lower tax receipts. Since the impact of GDP is considered to be zero, the impact on the exchequer is also considered to be zero.

#### **Wider Impacts**

39. The wider impacts of the introduction of bail-in powers are covered in the primary IA. These are largely driven by how the industry will respond to the measures and as such, cannot be predicted with certainty. There is no change to wider impacts as a result of these measures from that stated in the primary IA.

#### **Impact on small and micro businesses**

40. The Government estimates that these measures will have no impact to small and micro businesses. The impact on small and micro businesses for the use of the primary bail-in tool is expected to be zero. This is because, even the smallest bank or building society will not be either small or micro. Even if such a bank did exist, then it is unlikely that its failure would meet the statutory test to use the bail-in tool. This test requires the powers are only necessary in the interest of protecting UK financial stability, public confidence in the financial system, protection of depositors and protection of client assets. Therefore, these measures, which prescribe more detail on the tools use and are not expected to increase costs over above what has already been estimated for the primary tool, are not expected to have an impact on small and micro businesses.
41. There may be an impact on small and micro businesses to the extent they are customers of larger banks or building societies. A small or micro business will benefit from greater financial stability in the wider market. To the extent small and micro businesses are borrowers from large banks or building societies, they may face a higher cost of borrowing. However, this depends on the extent to which banks pass on any cost increases to customers. This is difficult to estimate and is a commercial decision for banks. As such this has not been included in this IA.

### **Exemption from the One-in-Two-out Rule**

42. These measures are specifically intended to make the bail-in tool more credible and effective. The bail-in tool is designed to reduce the systemic financial risk in the UK banking sector by increasing financial stability and providing a viable alternative to insolvency or public bail-out. There is an exemption for measures dealing with systemic financial risk in the Better Regulation Executive's One-in-Two-out Rule<sup>6</sup>. These measures also implement an EU Directive. European Union Regulation, Decisions and Directives are out of scope of the OITO rule.

### **Equality impact**

43. The Government has considered its obligations under the Equalities Act 2010. The Government does not believe these measures will impact upon discrimination, harassment, victimisation and other conduct prohibited under that Act, or equality of opportunity between people who have protected characteristics under the Act and those who do not, or good relations between people who share relevant protected characteristics under the Act and those who do not.
44. The Government considers that the proposals are compatible with the Convention rights protected by the Human Rights Act 1998.

### **Summary of IA and implementation plan**

#### Chosen policy option

45. The Government proposes to proceed with the lead option (option 2). This is because these measures are needed in order for the UK authorities to have an effective, full bail-in regime

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<sup>6</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf)

at their disposal and in line with the requirements of the BRRD. Having this tool, and greater confidence in its execution, will increase the financial stability of the UK banking sector and reduce the risk of public funds being required to support the banking sector.

### Implementation plan

46. A consultation on these Orders has now closed and respondents' views have been incorporated into the measures. Following the responses from industry, the Government plans to lay the necessary secondary legislation to bring these measures into force in line with the transposition of the BRRD.