

FINANCIAL SERVICES (BANKING REFORM) ACT 2013

EXPLANATORY NOTES

COMMENTARY

Part 3 – Bail-in Stabilisation Option

Section 17: Bail-in stabilisation option

102. *Section 17* of and *Schedule 2* to the Act make provision for a new stabilisation option (“the bail-in option”) under Part 1 of the Banking Act 2009 (“the 2009 Act”). *Subsections (2) to (5)* of section 17 give the Treasury power by order to make provision in consequence of the application of the new stabilisation option to building societies.
103. Part 1 of Schedule 2 amends the 2009 Act.
104. *Paragraph 2* inserts *new sections 12A and 12B*. *New section 12A(1) and (2)* describe the bail-in option which is to be the third stabilisation option in Part 1 of the 2009 Act. The bail-in option is to make one or more resolution instruments. *Subsections (3) to (5)* describe the provision and proposals that may be made in a resolution instrument. The Bank may make special bail-in provision (see *new section 48B*) for the purposes of reducing or deferring liabilities of the bank that are not excluded liabilities (as defined in *new section 48B(8)*) and may transfer some or all of the securities of the bank to a bail-in administrator (see *new section 12B*) until such time as the bank has been stabilised and the Bank has identified transferees for the securities (for example, creditors affected by an application of the power to make special bail-in provision or private sector purchasers), following which an onward transfer resolution instrument may be made (see *new section 48V*). Resolution instruments may include any provision that may be made in a share transfer instrument (see sections 17 to 23 of the 2009 Act) and any provision that may be made in relation to the bail-in option (see *new section 12B* and *new sections 48B to 48S*).
105. *New section 12B* makes provision about bail-in administrators. *Subsection (1)* enables an individual or body corporate to be appointed as a bail-in administrator. A person appointed in this capacity would be appointed (a) to hold any securities of the bank that may be transferred or issued to that person in the capacity of bail-in administrator; and (b) to perform any other functions that may be conferred on the bail-in administrator under any provision of Part 1 of the 2009 Act (*subsection (2)*). It will be possible for the Bank to appoint one or more persons as a bail-in administrator. For example, one person could be appointed to hold securities, another may be appointed to prepare a business reorganisation plan under *new section 48H*. Alternatively, the Bank might choose not to transfer any securities of the bank to a bail-in administrator but may appoint a person to act as bail-in administrator for other purposes under Part 1 of the 2009 Act (for example, the preparation of the business reorganisation plan).
106. Securities held by a bail-in administrator (whether as a result of a resolution instrument or otherwise, for example, as a result of the issue of new securities to the bail-in

administrator during the course of the period in which the securities are held by the officer) will be held by the bail-in administrator as legal and beneficial owner. However, the securities would be held solely in accordance with the terms of a resolution instrument (*subsection (4)*). The securities would be held by the bail-in administrator only as long as is necessary having regard to the special resolution objectives following which the Bank of England may transfer (using the onward securities transfer power conferred by *new section 48V*), or otherwise authorise the disposal of, the securities held by the administrator to another person.

107. *Subsection (5)* ensures that a resolution instrument may include provision about the specified rights and obligations of the bail-in administrator with respect to all or any of the securities held by the administrator. For example, the Bank of England may choose to specify in the resolution instrument that the administrator is to exercise shareholder rights only in accordance with directions of the Bank.
108. *Subsection (6)* imposes a requirement on the bail-in administrator to have regard, when performing their functions, to such objectives as may be specified by the Bank of England in the resolution instrument under which the administrator was appointed. *Subsection (7)* makes it clear that should the Bank of England specify more than one objective for the officer, the objectives are to be taken to have equal status unless otherwise specified by the Bank.
109. *Paragraph 3* inserts a *new section 8A* into Part 1 of the 2009 Act. *New section 8A* sets out the specific condition that must be satisfied before the bail-in option may be deployed by the Bank of England. This is in addition to the conditions set out in section 7 of the 2009 Act (general conditions) in relation to failure, or likely failure, of the threshold conditions for authorisation (*subsection (4)*).
110. *Subsection (2)* sets out the condition to be satisfied: namely that the exercise of power is necessary having regard to one or more of the public interests listed in *paragraphs (a) to (d)*.
111. *Subsection (3)* requires the Bank of England to consult with the PRA, the FCA and the Treasury before determining whether the condition is satisfied.
112. *Paragraph 4* inserts *new sections 48B to 48W* into Part 1 of the 2009 Act.
113. *New section 48B* enables the Bank of England to make “special bail-in provision” in a resolution instrument. “Special bail-in provision” is defined by *subsection (1)* as provision involving one or more of the following: (a) cancelling a liability of the bank; (b) modifying a liability, or changing the form of a liability; and (c) providing that a contract is to have effect as if a specified right (such as a right to close out) had been exercised under it (*subsection (1)*). The purpose of this new power is to ensure that the Bank of England can take actions, having regard to the special resolution objectives specified in section 4 of the 2009 Act, to stabilise the bank under resolution by reducing or deferring its liabilities. For example, the power enables the Bank of England to convert all or part of the liabilities attaching to securities issued by a bank into another pre-existing or new form, type or class of securities. The power could be used, for instance, to convert a debt instrument partially into shares and partially into another type of debt security. It could also be used to modify the terms of a contract in order to suspend the bank’s obligations in relation to a liability for a certain period for the purpose of, or in connection with, reducing that liability.
114. *Subsection (4)* makes clear that the power to make special bail-in provision may be exercised only for the purpose of, or in connection with, reducing, deferring or cancelling a liability of the bank. It also makes it clear that the power may not be exercised so as to affect an excluded liability (that is a liability of a kind listed in *subsection (8)*).
115. *Subsection (5)* sets out the rules which apply to the interpretation of *subsection (1)*. *Subsection (6)* provides examples of special bail-in provision.

116. *Subsection (8)* makes provision in relation to the liabilities of the bank that are “excluded liabilities” and may not be affected by an exercise of powers under *subsection (1)*. For example, deposits covered by the Financial Services Compensation Scheme may not be affected by an exercise of these powers. Relevant terms are defined in *new sections 48C* (defining “protected deposit”) and *section 48D* (making provision for the interpretation of other specified terms).
117. *New section 48E* imposes a requirement on the Bank of England to produce a report where it makes a resolution instrument containing provision made in reliance on *new section 48B* (a similar reporting requirement exists where special bail-in provision has been made in property transfer instrument (see *new section 44C*)). The report must be provided to the Chancellor of the Exchequer (*subsection (2)*) who must lay before Parliament a copy of each report received from the Bank (*subsection (7)*). Each report has to be made as soon as reasonably practicable after the making of the resolution instrument to which the report relates. The report must, in particular, explain any departure from the principles related to how liabilities would be treated in insolvency (*subsections (3) and (4)*), namely the order of priority on liquidation and loss bearing on an equal footing for creditors having equal priority.
118. *New section 48F* confers on the Treasury a power, by order subject to the draft affirmative procedure, to amend the definition of “excluded liabilities” set out in *new section 48B(8)*. This power may not be used so as to amend or omit *new section 48B(8) (a) to (c)*.
119. *New section 48G* confers on the Treasury a power, by order subject to the draft affirmative procedure, to specify matters or principles to which the Bank of England must have regard in making an instrument that includes special bail-in provision. These may be the insolvency treatment principles of *new section 48E(4)* or alternative principles (*subsection (2)*). *Subsection (4)* allows the insolvency treatment principles to be amended. If new principles are specified under an order made under *new section 48G(1)*, this allows, for example, the insolvency treatment principles to be aligned with those principles.
120. *New section 48H* makes provision about business reorganisation plans.
121. *Subsection (1)* specifies that a resolution instrument may require a bail-in administrator, or one or more directors of the bank under resolution, to draw up a business reorganisation plan with respect of the bank, and to submit it to the Bank of England within the period allowed by or under the instrument. Other provision may also be made in the instrument in connection with provision under *subsection (1)* (see further *subsection (7)*).
122. *Subsection (2)* defines “business reorganisation plan”. Such a plan is to include specified matters, including an assessment of the factors that caused Condition 1 in section 7 of the 2009 Act (general conditions) to be satisfied in relation to the bank under resolution and a description of the measures to be adopted with a view to restoring the viability of the bank. “Viability” is assessed by reference to the matters referred to in *subsection (8)*.
123. Each business reorganisation plan must be approved by the Bank of England (*subsection (3)*). Before deciding whether to approve the plan, or to require the person who has submitted the plan to amend the plan, the Bank of England must consult with the PRA and the FCA as the regulators responsible for the ongoing supervision of the bank (*subsection (5)*).
124. A business reorganisation plan may include recommendations on the exercise by the Bank of England of its powers under Part 1 of the 2009 Act in relation to the bank under resolution (*subsection (6)*). For example, if a bail-in administrator has identified a potential purchaser for some of the business on the bank under resolution, the bail-in administrator may recommend to the Bank of England that it make a property transfer

instrument under *new section 41A* to effect the sale and transfer of that business. The Bank would be under no obligation to follow the recommendations of the person who has prepared the plan. However, the Bank of England may take into account these recommendations in determining what further steps to take in relation to the bank in pursuance of the special resolution objectives specified in section 4 of the Act.

125. *New sections 48I to 48K* make provision about bail-in administrators.
126. *New section 48I* makes it clear that a resolution instrument may include further provision about the functions of a bail-in administrator. *Subsection (1)* provides that a resolution instrument may, for example, authorise a bail-in administrator to manage the bank's business and to exercise any powers of the bank. *Subsection (2)* provides that a resolution instrument may require a bail-in administrator to make reports to the Bank of England on such matters as may be specified in the instrument. *Subsection (3)* specifies that the instrument may provide for further requirements as to the content of any report required under *subsection (2)*. And *subsection (4)* specifies that a resolution instrument may require a bail-in administrator to consult specified persons (such as the Bank of England) or first to obtain the consent of a specified person before taking specified actions, such as exercising voting rights in relation to the securities held by the bail-in administrator.
127. *New section 48J* makes supplementary provision about bail-in administrators. *Subsection (1)* specifies that a bail-in administrator may do anything necessary or desirable for the purposes of or in connection with the performance of the functions of the office. *Subsection (2)* makes it clear that a bail-in administrator is not a servant or agent of the Crown. *Subsection (3)* requires the Bank of England to make provision in a resolution instrument for the resignation and replacement of a bail-in administrator and addresses the removal from office of a bail-in administrator.
128. *New section 48K* makes provision about the remuneration and allowances of the bail-in administrator. In particular, *subsection (2)* specifies that the Bank of England may provide that remuneration and allowances are to be paid by the Bank or by the bank under resolution. Under *subsection (3)* a bail-in administrator is protected from liability in relation to anything done in good faith, except damages awarded under section 8 of the Human Rights Act 1998.
129. *New section 48L* makes it clear that a resolution instrument may cancel or modify any securities which fall within Class 1 in section 14 (*subsection (2)*) or convert any such securities from one form or class into another (see further *subsection (4)*). This section also clarifies that a resolution instrument may make provision with respect to the rights attaching to securities (for example, it may enable the Bank of England or a bail-in administrator to exercise voting rights attaching to the bank's shares during a resolution), and provide for the listing of securities issued by the bank to be discontinued (see further *subsection (6)*). *Subsection (7)* also clarifies that the provision that may be made under this section is in addition to any provision that the Bank of England may make under *new section 48B* (special bail-in provision).
130. *New section 48M* ensures that the Bank of England can make in a resolution instrument provision of a kind that may be made in a share transfer instrument or property transfer instrument under the 2009 Act for the purposes of turning off default event rights that may otherwise be triggered (see sections 22 and 38 of the 2009 Act).
131. *New section 48N* ensures that the Bank of England can make the same provision in a resolution instrument as in a share transfer or property transfer instrument regarding the directors of the bank under resolution (see sections 20 and 36A).
132. *New section 48O* confers on the Bank of England a power to issue directions to one or more directors of the bank under resolution.
133. *New section 48P* confers on the Treasury a power to make orders, subject to the draft affirmative procedure, for safeguarding certain financial arrangements. (The power is

analogous to section 48, which allows safeguards to be put in place under existing stabilisation options involving partial property transfers.)

134. *New section 48Q* provides that a resolution instrument may make provision in relation to continuity. For example, a resolution instrument might provide for anything that relates to anything affected by the instrument that is in the process of being done before the instrument takes effect to be continued from the time the instrument takes effect.
135. *New section 48R* specifies that a resolution instrument may permit or require the execution, issue or delivery of an instrument.
136. *New section 48S* makes it clear that provision specified in a resolution instrument takes effect despite any restriction arising by virtue of contract or legislation or in any other way and may include incidental, consequential or transitional provision.
137. *New section 48T* sets out the procedural arrangements that apply in relation to the making of a resolution instrument by the Bank of England. These are the same as apply where the Bank makes a share transfer instrument or property transfer instrument using its existing powers under the 2009 Act (see sections 24 and 41).
138. *New section 48U* enables the Bank of England to make one or more supplemental resolution instruments following the making of a resolution instrument under *new section 12A(2)*. A supplemental resolution instrument may make any provision of a kind that may be made in a resolution instrument under *new section 12A(2)*.
139. *New section 48V* confers on the Bank of England power to make one or more onward transfer resolution instruments, for example, to transfer securities that were transferred to a bail-in administrator as a result of provision in a resolution instrument under *new section 12A(2)* to such other persons as the Bank may identify (e.g. creditors affected by an application of the power to make special bail-in provision or a private sector purchaser).
140. *New section 48W* confers on the Bank of England a power to transfer back to the original holders any securities transferred by a resolution instrument or an onward transfer resolution instrument.
141. *Paragraph 5* of Schedule 2 makes provision about the transfer of the property of a bank in relation to which the bail-in option has been deployed.
142. *Sub-paragraph (1)* insert *new section 41A* which enables the Bank of England to transfer property, rights or liabilities of a bank to which the bail-in option has been applied. For example, this power could be exercised to transfer to a private sector purchaser a portfolio of assets in the event a purchaser could be identified.
143. *Sub-paragraph (2)* makes consequential amendments to section 42 of the 2009 Act, so as to enable the Bank of England to make a supplemental property transfer instrument following the making of a property transfer instrument under *new section 41A*. *Sub-paragraph (4)* also makes consequential amendments.
144. *Sub-paragraph (3)* inserts *new sections 44A to 44C* which enable the Bank of England to make a reverse property transfer where a property transfer instrument has been made in accordance with *new section 41A(2)*. *New section 44B* concerns property transfer instrument under section 12(2) or *new section 41A(2)* (and certain types of supplementary property transfer instruments). It allows such instruments to make special bail-in provision of a kind described in *new section 48B*. *New section 44C* replicates the reporting requirement which appears in *new section 48E* in relation to property transfer instruments containing special bail-in provision.
145. *Paragraph 6* makes provision about the compensation arrangements to be put in place following the making of a resolution instrument under *new section 12A(2)* and other relevant forms of instrument.

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2013 (c.33) which received Royal Assent on 18 December 2013*

146. *Sub-paragraph (1)* amends section 49, which describes the different forms of compensation arrangements that may be made in connection with different stabilisation options, to provide for a new form of compensation order: a “bail-in compensation order”.
147. *Sub-paragraph (3)* inserts a *new section 52A* into Part 1 of the 2009 Act which provides that the Treasury must make a bail-in compensation order where the Bank of England makes a resolution instrument in accordance with *new section 12A(2)* or a property transfer instrument under *new section 41A(2)*.
148. *Sub-paragraph (4)* makes a number of consequential amendments to section 53 of the 2009 Act to take account of the new forms of transfer instrument which the Bank of England may make. This ensures that the Treasury can make appropriate compensation arrangements following onwards, reserve and supplemental transfers.
149. *Sub-paragraphs (5) to (7)* make consequential amendments to sections 54, 56 and 57.
150. *Sub-paragraph (8)* inserts *new sections 60A* and *60B*. They enable the Treasury to make regulations concerning the mandatory compensation provision to be included in the compensation arrangements to be put in place following the making of instruments by the Bank of England that include special bail-in provision. In making the regulations, *new section 60B* requires the Treasury, in particular, to have regard to the desirability of ensuring that pre-resolution shareholders and creditors do not receive less favourable treatment than they would have done had the bank entered into insolvency immediately before the coming into force of the initial instrument (e.g. in the case of the bail-in option, the first resolution instrument made under *new section 12A*). *New section 60A(5) (b)* provides that the regulations are subject to the draft affirmative procedure.
151. *Sub-paragraphs (2), (9) and (10)* make other consequential amendments.
152. *Paragraph 7* inserts *new section 81BA* and *new section 81CA* and amends section 81D (interpretation: “banking group company” etc).
153. *New section 81BA* enables the Bank of England to exercise the bail-in option in relation to a banking group company where certain conditions are met. In particular, in addition to the conditions being satisfied in relation to the bank it would have, in the opinion of the Bank of England, to be necessary to take action at the level of the banking group company having regard to various public interests (see Condition 2). This is consistent with the approach to the application of the Bank’s other stabilisation options in relation to banking group companies (see section 81B of the 2009 Act (sale to a commercial purchaser and bridge bank)).
154. *New section 81CA* specifies how the provisions relating to bail-in are to be interpreted where the Bank of England deploys the bail-in option at the level of the parent undertaking of the failing bank. In most cases the provisions are to be interpreted as applying to both the bank and the parent undertaking (see the “general rule” in subsection (4)). However, in certain cases, the powers are also exercisable in relation to any other banks in the group, for example, so as to permit the Bank of England to transfer the shares of any bank in the group to a commercial purchaser (see subsection (5)(b)). This is consistent with the approach in relation to the application of powers where the Treasury transfer the shares of a holding company of a failing bank into public ownership (see section 82 (temporary public ownership) and section 83 (supplemental) of the 2009 Act).
155. *Sub-paragraph (3)* makes consequential amendments to section 81D in order to take account of the new sections.
156. *Paragraph 8* makes certain consequential amendments in respect of new sections inserted by the Act as they apply to banks which are regulated only by the FCA, for instance to provide that the Bank of England need only consult the FCA and the

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Treasury in relation to the *new section 8A* specific condition in such cases unless the bank has a member of its immediate group that is a PRA-authorized person.

157. *Paragraph 9* prevents the amendments of the 2009 Act relating to the bail-in option from applying to recognised central counterparties. This is because the bail-in tool is not designed for such entities.
158. *Paragraph 10* amends section 120 of the Banking Act 2009 (notice to PRA of preliminary steps to certain insolvency proceedings) so as to ensure that an order placing a bank into an insolvency proceeding may not be made unless the Bank of England has provided its consent where the bank has been placed into resolution under the bail-in option in the previous three months. The effect would be to ensure that actions can be taken to stabilise the bank under resolution without risk that they may be undermined by insolvency proceedings.
159. *Paragraph 11* inserts in the 2009 Act a *new section 256A* which confers on the Treasury a power to issue directions to a bail-in administrator in connection with the provision of State aid to the bank under resolution. This power would be similar to the power conferred by section 145A of the 2009 Act (power to direct bank administrators) in relation to bank administrators.
160. *Paragraph 12* amends section 1 of the 2009 Act (overview) so as to take account of the bail-in option (which becomes the new “third” stabilisation option). *Paragraph 13* makes a consequential amendment to section 13 of the 2009 Act (temporary public ownership) so that temporary public ownership becomes the “fourth” stabilisation option. *Paragraph 27* makes a similar amendment of section 85 of the 2009 Act (temporary public ownership).
161. *Paragraphs 14 to 16* make consequential amendments to certain provisions of the 2009 Act to reflect the introduction of a new form of instrument - a resolution instrument.
162. *Paragraphs 17 to 20* make consequential amendments to provisions regarding continuity obligations (sections 63 and 66 to 68 of the 2009 Act). These amendments ensure that the general continuity provisions apply, and special continuity obligations may be applied, in relation to certain kinds of transfer in relation to an application of the bail-in stabilisation option and relevant subsequent transfers.
163. *Paragraphs 21 to 23* make further consequential amendments to sections 71 (pensions) to 73 (disputes) of the 2009 Act.
164. *Paragraph 24* makes minor amendments to section 74 of the 2009 Act (tax) to take account of certain new transfer powers conferred on the Bank of England in this Act.
165. *Paragraphs 25 and 26* make provision in relation to reporting requirements where the Bank of England makes one or more resolution instruments under *new section 12A(2)*. In particular, the Bank must to report to the Treasury about the matters referred to in subsection (2) of new section 80A. The Chancellor is required to lay before Parliament a copy of each report provided to the Treasury under subsection (2).
166. *Paragraphs 28 and 29* amend Part 3 of the 2009 Act (bank administration) so as to enable a bank subject to the exercise of powers described in *new section 152A(2)* to be placed into the bank administration procedure.
167. *Paragraph 30* amends section 220 of the 2009 Act (insolvency etc) so as to make clear that the transfer of ownership of a bank to a bail-in administrator has no effect as regards its permission to issue banknotes pursuant to Part 6 of the 2009 Act.
168. *Paragraph 31* makes minor amendments to section 259 of the 2009 Act (statutory instruments) to take account of new statutory instruments which may be made pursuant to amendments of the 2009 Act as provided for in this Act.

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169. *Paragraph 32* makes minor amendments to section 261 of the 2009 Act (index of defined terms).
170. *Part 2 of the Schedule (paragraph 33)* modifies the Investment Bank Special Administration Regulations 2011 in their application to cases where a resolution instrument has been made with respect to an investment bank.