

# **Bank (Recovery and Resolution) Bill 2020**



## **Consultation**

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**Treasury**

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## **1. Executive summary**

### **What is this Consultation Paper about?**

Following the Global Financial Crisis which erupted in 2007, various governments and international standard setting agencies have made significant advances in developing the legal, policy and operational frameworks necessary to ensure that future bank failures i) take place in an orderly fashion and ii) impose costs on the creditors and shareholders of the failed firm (through 'bail-in'), as opposed to imposing costs on taxpayers (through 'bail-out'). The Financial Stability Board has articulated a set of 'Key Attributes of Effective Resolution Regimes for Financial Institutions'<sup>1</sup>, endorsed by the G20 Governments, which have since informed the development of Bank Recovery and Resolution ('**BRR**') regimes in many countries.

The aims of a BRR regime are to ensure the continuation of critical banking functions, to protect covered depositors and client assets, to avoid negative effects on financial and economic stability and to minimise reliance on public financial support to failing banks. In addition, to provide for speed and transparency and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution.

Following a period of engagement involving the Treasury, the Isle of Man Financial Services Authority, IoM licensed banks and their professional advisers, the Isle of Man Treasury intends to introduce legislation to implement a BRR framework which will ensure that the Island has the necessary procedures in place both to plan for the possibility of a future bank failure and also the powers to intervene appropriately in such a situation. This is particularly important as the Island may need to participate in a cross-border resolution of a banking group at some stage, given that the majority of banks operating here are headquartered in other jurisdictions.

The draft Bank (Recovery and Resolution) Bill 2020 is appended to this consultation paper and a general overview of the main aspects of the Bill is additionally provided in this document.

### **Who is it for?**

This consultation paper is being issued to the general public and all comments and observations are welcome. It is anticipated the consultation will be of particular interest to stakeholders in the banking profession and to their professional advisers and those persons involved with corporate insolvency matters.

### **What feedback is requested?**

Feedback on any aspect of the draft Bill is appreciated, as requested in Section 6, prior to the Bill being presented to the Branches of Tynwald for consideration. Details of how feedback should be provided and how feedback will be treated, are set out at Section 7.

Following analysis of responses to this consultation paper, it is envisaged that a finalised draft Bill will be introduced to the House of Keys at the earliest opportunity thereafter.

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<sup>1</sup> See [http://www.fsb.org/wp-content/uploads/r\\_141015.pdf](http://www.fsb.org/wp-content/uploads/r_141015.pdf)

## 2. Introduction and background

In the wake of the Global Financial Crisis ('GFC'), on an international level a great deal of work has been undertaken to address the issue of banks being 'too big to fail' – i.e. to ensure that the cost burden of any future bank failure is for the account of its shareholders and creditors, and not for the taxpayers, who ultimately 'bailed-out' troubled banks during the GFC. One reason for the 'bail-out' approach which had been widely adopted by national governments at that time, was the lack of suitable alternatives to a conventional corporate liquidation of a troubled bank, which if allowed to happen would have had unacceptable consequences for the financial stability of the national and indeed global economy.

Governments and standard-setting agencies have since been at the forefront of policy and legislative updates in many jurisdictions, with the intention of making banks more resilient (and thus reducing the likelihood of failure) and providing a set of tools which can be used by appropriate authorities in the event that a bank is still considered as 'failing or likely to fail' ('FLTF'), to minimise the impact of failure. The process under which the authorities might act in such a circumstance is generally referred to as Resolution.

## 3. International Standards and implementation approaches

Informed by the Key Attributes established by the Financial Stability Board ('FSB'), the EU enacted the Bank Recovery and Resolution Directive ('BRRD'<sup>2</sup>) in 2014 and, in common with other EU nations, this was transposed into UK national law in 2015. The Bank of England is the National Resolution Authority<sup>3</sup> in the United Kingdom. In the Eurozone member states, this role is held by the Single Resolution Board<sup>4</sup>, an agency of the European Union, which works closely with the National Resolution Authorities in each of the Eurozone member states (to which the SRB delegates certain resolution tasks).

In May 2017, Jersey enacted its Bank (Recovery and Resolution) (Jersey) Law 2017<sup>5</sup>, which closely follows the provisions of the BRRD, although at the time of writing, the Jersey legislation has not yet been brought into force.

## 4. The current Isle of Man position

At present, there are significant gaps between the FSB Key Attributes and the current Isle of Man framework for dealing with a failing or failed bank. As countries around the world mature in their policy and legislative approaches to the issue of bank resolution, the Isle of Man, although not a G20 member, must nevertheless consider its own response to these developments, as a leading and responsible International Financial Centre.

In addition to reflecting international standards, there are other motivations for the Isle of Man to ensure that it has an adequate BRR regime in place. In particular, the cross-border nature of operations of many banking groups present on the Isle of Man makes it important that the Isle of Man can participate effectively alongside other countries' Resolution

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<sup>2</sup> See [https://ec.europa.eu/info/law/bank-recovery-and-resolution-directive-2014-59-eu\\_en](https://ec.europa.eu/info/law/bank-recovery-and-resolution-directive-2014-59-eu_en), as subsequently amended by [Directive 2019/859](https://eur-lex.europa.eu/eli/dir/2019/859/oj)

<sup>3</sup> See <https://www.bankofengland.co.uk/paper/2017/the-bank-of-england-approach-to-resolution> for an overview of the Bank of England's approach to resolution

<sup>4</sup> See [https://srb.europa.eu/sites/srbsite/files/intro\\_resplanning.pdf.pdf](https://srb.europa.eu/sites/srbsite/files/intro_resplanning.pdf.pdf) for an overview of the SRB's approach

<sup>5</sup> See <https://www.jerseylaw.je/laws/enacted/Pages/L-10-2017.aspx>

Authorities, in any resolution action which may have an impact on a banking group's operations in the Island.

Current analysis further suggests that the present policy and legislative framework in the Island does not permit the deployment of a sufficiently flexible range of measures to deal with a distressed bank, including a bank headquartered and incorporated elsewhere but with a presence in this jurisdiction via a subsidiary or branch structure. At present the only mechanism available for a locally incorporated bank entity which has reached the point of non-viability is liquidation which, in the case of a bank offering a wide range of services in the local economy such as deposit taking, home and business lending, access to payment systems etc...(collectively described in the BRRD as 'critical functions') could present unacceptable difficulties for the local economy and population – as access to all critical functions would essentially cease at the point of liquidation.

It is therefore intended that a legal framework for BRR, based on international standards already adopted by jurisdictions such as the United Kingdom, the Eurozone member states and Jersey, tailored where appropriate to the Isle of Man's needs, be introduced at the earliest opportunity.

This work is being undertaken in tandem with the ongoing work being progressed by the Treasury on updating the Isle of Man Depositors' Compensation Scheme ('DCS'), which is another important element of the Isle of Man's 'financial safety net'. Although the BRR and DCS frameworks each have distinctive elements, a co-ordinated approach to their development is being undertaken.

## **5. Overview of the Draft BRR Bill**

The draft BRR Bill is closely modelled on the FSB's Key Attributes and upon related legislation which has been enacted in the United Kingdom, Europe and Jersey. An important consideration in developing the Bill was to aim for as large a degree of consistency as possible for those banks with operations spanning the Crown Dependencies. Although the Bill is a complex piece of legislation, fundamentally all of its main provisions have already been adopted by other leading financial centres such as those just referenced. There are no key proposals within the draft Bill which could be considered unique to the Isle of Man in terms of the intended approach to bank resolution.

During the process of developing the Bill, dialogue has taken place with representatives of the Isle of Man Bankers' Association, the Isle of Man Law Society, the Isle of Man Society of Chartered Accountants and other stakeholders. The input received to date has been factored into the Bill which is now being consulted upon.

The Bill is laid out in Parts. The overall purpose of each Part is summarised below. Throughout the summary, some explanatory information has been included to provide further context to the provisions contained within various Parts of the Bill.

### **PART ONE:**

Part One deals with preliminary matters, including setting out definitions for a number of key terms used throughout the Bill. Part One also clarifies the scope of the Act as pertaining to banks operating in the Isle of Man through either locally incorporated entities or branch structures (together with their holding companies and subsidiaries, where appropriate)

under a Class 1(1) or Class 1(2) licence to take deposits. Class 1(3) licences, which relate to representative offices of banks, are not in scope of the proposed BRR legislation.

#### PART TWO:

Part Two establishes that there shall be a Resolution Authority ('**RA**') for the Isle of Man and that the designated RA will be the Isle of Man Financial Services Authority ('**FSA**'). This will be in addition to the wide range of responsibilities the FSA has under existing legislation. Importantly, the FSA will be required to make and publish regulations setting out its arrangements to ensure there is operational separation between its new Resolution function and its existing Supervisory functions, given that there could be a perceived potential for conflict between these two roles. This model of combining responsibility for Resolution and Supervision within the same organisation is already active in many other jurisdictions, including the United Kingdom and Ireland. Throughout the Bill, references to 'the Authority' should be construed as meaning the FSA as a body corporate, albeit that certain activities may fall to the FSA acting in its capacity as the RA or its capacity as the Supervisory Authority for the regulated financial sector.

Post the GFC, there has been a growing acceptance internationally of the principle that the costs of ensuring a safer and more resilient banking system, should be borne by the banks who themselves will generate profits as a consequence of the greater safety and soundness of that industry. The Isle of Man will experience a new ongoing expense in relation to the introduction of a BRR framework, concerning the administration costs of the RA on a 'business as usual' basis. In general terms this will relate to the salary and related costs of any staff member employed by the RA. Part Two of the Bill provides flexibility as to how such costs may be covered, including from the banking industry amongst other sources. This is designed to cater for changing economic circumstances over time, which may periodically alter the chosen funding strategy.

#### PART THREE:

Part Three sets out the requirement for banks to produce and maintain Recovery Plans. Recovery planning is an activity which banking groups must undertake themselves to document management actions open to the bank to deal with recovery from a severe stress situation. The bank examines its options and identifies a range of credible measures which it can take to restore its operations to good financial health. Recovery Plans are thereafter shared with the bank's supervisory authority, which in the case of the Isle of Man is the FSA. The FSA has already introduced recovery planning requirements for locally incorporated banks<sup>6</sup>, however Part Three of the Bill formalises the requirements in respect of both incorporated banks and branches operating in the Island and also sets out the FSA's powers in relation to Recovery Plans.

#### PART FOUR:

Part Four sets out the requirements of the RA in relation to Resolution Plans for banks incorporated in the Island. Resolution planning is the responsibility of the RA, who are responsible for preparing and maintaining Resolution Plans to deal with the failure of any of the banks operating in the jurisdiction – e.g. in circumstances where the bank's own Recovery Plan has been unsuccessful in returning it to financial health. The cross-border and branch / subsidiary composition of banks operating in the Isle of Man may mean in

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<sup>6</sup> See <https://www.iomfsa.im/media/2496/recovery-planning-industry-guidance.pdf>

certain instances that the Resolution Plan is prepared in another jurisdiction, in which case the Isle of Man RA's role is to engage with the overseas resolution authority, review the Resolution Plan from the perspective of how it relates to the Isle of Man operations of the bank concerned, and provide input to and feedback on the Plan where relevant.

In addition to ongoing resolution planning, the RA will periodically undertake Resolvability Assessments. This process is designed to review the feasibility and credibility of the preferred resolution strategy for each bank concerned and to identify any issues which might prevent the smooth execution of the strategy, known as 'impediments to resolution', which may be structural or operational in nature. Following the identification of impediments, the RA will have the power to identify these to the bank concerned and to compel the bank to develop proposals which will lead to their removal. Again in a cross-border scenario, the home resolution authority of the banking group concerned would conduct the resolvability assessment and it would be the responsibility of the Isle of Man RA to review this assessment and to confirm acceptance, or otherwise, of its conclusions and to communicate this to the home resolution authority.

Finally, Part Four also introduces a new regulatory requirement for banks incorporated in the Isle of Man to hold a minimum level of own funds and eligible liabilities, known as '**MREL**'. Where the preferred resolution strategy for a bank is for it to be wound-up in an orderly manner, the level of MREL will be the same as the bank's existing minimum capital requirement, as currently set by the FSA. In instances where the preferred resolution strategy is for a bank to be resolved rather than liquidated, the MREL requirement *may* be set at a higher level, thus requiring the bank concerned to hold a proportionately higher level of capital in order to help support a potential resolution action.

#### PART FIVE:

Part Five deals with the establishment and funding of a Bank Resolution Fund, under the control of the RA. Were a resolution action to affect a FLTF bank (or a subsidiary bank) incorporated in the Isle of Man which required costs to be incurred, there must be a readily available source of funding to support any necessary actions. One such example would be the need to cover the costs of obtaining an independent valuation of the assets and liabilities of a bank as it reaches the point of non-viability. As more fully described in Part Seven of the Bill, this valuation would be used to inform decisions of the RA in relation to the resolution strategy to be pursued and, inter alia, to determine the extent to which any categories of bank liabilities might become subject to 'bail-in' provisions. A further function of the Bank Resolution Fund is the consideration of claims from, and potential payments of compensation to, shareholders and/or creditors of a bank in resolution under the 'no creditor worse off than in liquidation' provisions set out in Part Ten of the Bill. Given both the nature and potential materiality of calls on the Bank Resolution Fund, the Bill contains clear safeguards which are to be put in place as regards its operation. This includes the need to require the consent of the Treasury before any expenditure may be incurred by the Bank Resolution Fund, in addition to a defined set of permitted and prohibited uses.

It is intended that any expenses incurred by the Bank Resolution Fund should first of all be recovered to the extent possible, from the bank in resolution, as a preferred creditor. In the unlikely event that there then remains an irrecoverable shortfall from that source, it is proposed that this be recovered generally from the banking industry, over a ten year time period. Mindful of the need for proportionality and to avoid a prohibitive level of contingent

financial risk to banks operating on the Isle of Man, detailed consideration has been given to how the Bank Resolution Fund should be structured in this jurisdiction, and a total financial cap on the Bank Resolution Fund of £60 million<sup>7</sup> is proposed. For the sake of clarity, it should be noted that the Bank Resolution Fund is of relevance only in circumstances when it is proposed that a FLTF bank be subject to a resolution process as opposed to being liquidated. In the case of a liquidation, it is the DCS which is of relevance.

It is not proposed that the Isle of Man builds up a standing reserve in the Bank Resolution Fund through an *ex-ante* system of contributions levied upon banks operating on the Isle of Man. That said, nor is it proposed that public monies be used or earmarked as a source of permanent funding for the Bank Resolution Fund. However, it is recognised that in the event of a resolution action the Bank Resolution Fund may need to seek a source of immediate funding (for example, in order to engage a specialist firm to undertake a valuation exercise). Consequently, the proposed approach is that the Bank Resolution Fund has the power to borrow, including from Government resources in the short term, subject to full repayment with interest, to be repaid from the Resolution Fund's income sources (such as recoveries from the bank in resolution, or possibly through contributions from the banking sector generally).

#### PART SIX:

This Part sets out a number of different provisions, including articulating the objectives of and strict conditions for, carrying out a resolution action. This includes setting out when a bank would be deemed as 'failing or likely to fail' and that in all cases other than where a FLTF bank is of systemic importance to the Isle of Man, the preferred course of action would be to bring about its orderly winding-up.

#### PART SEVEN:

Part Seven sets out the various requirements and procedures for valuations in relation to a resolution action. These are required at the outset, to help inform the decision on the most appropriate stabilisation tool to use (if any) and subsequently, when a bank is resolved, to compare the losses actually incurred by shareholders and creditors with the loss that they would have in theory incurred had the failing bank been liquidated rather than resolved.

#### PART EIGHT:

This Part articulates in detail, the various stabilisation tools which may be utilised when dealing with a FLTF bank. The FSB's Key Attributes identify that Resolution Authorities should have a wide range of powers, designed to deal with stabilising a FLTF bank in a variety of different ways.

By way of brief overview, these stabilisation powers are:

- Transfer of some or all of the business of the FLTF bank to another bank
- Transfer to a 'bridge bank' (a temporary bank in public ownership, until such times as it has been stabilised and sold to a private sector purchaser)

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<sup>7</sup> This broadly equates to 1% of DCS-covered deposits in the Isle of Man and so is consistent with the 1% of covered deposits level of funding being accumulated by the broadly similar Single Resolution Fund in Europe.



- Transfer to an Asset Management Vehicle (a public agency which will hold the transferred assets and seek to realise increased value from their sale, or wind-down, over a protracted timescale)
- Utilisation of 'bail-in' powers to write down the value of creditors' debt claims on the bank (which can include certain classes of deposit) sufficient to absorb present and expected losses and to sufficiently recapitalise the bank concerned and restore it to financial viability
- In extreme situations, the injection of government funds to provide capital support to the FLTF bank allowing it to once again meet the conditions of its license (covered in Part Nine of the Bill)
- In addition to the stabilisation powers, a bespoke bank winding-up procedure (as set out in Part Thirteen of the Bill) can be used in conjunction with some of the above powers to liquidate a residual bank entity.

It is considered highly unlikely that the Isle of Man would wish, or need, to act in isolation to utilise the stabilisation powers listed above, on a 'stand-alone' basis. However, it is considered more likely that, in the event of a resolution event impacting a bank operating on the Island on a cross-border basis, there may be a need to approve and potentially facilitate a co-ordinated resolution action led by a home resolution authority, involving the use of the stabilisation powers listed above, under Isle of Man legislation. As a result, it is proposed that the RA be legally enabled to consider using the full range of stabilisation powers mentioned above. This approach reduces the risk of potentially having to consider changes to the Isle of Man's BRR framework in future (e.g. to enable the use of a stabilisation power not included in the legislation from the outset), particularly during a crisis event.

#### PART NINE:

Part Nine makes provisions for the possibility of Government Financial Assistance to a FLTF bank as a 'last resort' option, where the other stabilisation tools set out in Part Eight are considered insufficient when dealing with a financial crisis.

#### PART TEN:

This Part covers a range of general resolution powers and related issues, including the ability to write down and convert capital instruments of a FLTF bank and also the 'no creditor worse off than in liquidation' safeguard. This safeguard provides that, in the event of a resolution action imposing losses on shareholders and creditors of a failed bank, those losses should not be greater than would have been suffered had the bank been placed in liquidation rather than being resolved. Should this be the case, then a claim for compensation for the excess loss suffered may be made against the Bank Resolution Fund.

#### PART ELEVEN:

Part Eleven sets out the ability of the RA to recognise, or decline to recognise, a resolution action which is initiated in another country regarding a FLTF bank and which potentially could affect that bank's operations in the Island.

#### PART TWELVE:

Part Twelve establishes the requirement for the RA to make a report to the Treasury subsequent to any resolution action being taken in the Island. Such a report must be made

within twelve months of the resolution action occurring and, amongst other things, must set out an assessment of 'lessons learned'.

#### PART THIRTEEN:

A feature of BRR legislation introduced in many jurisdictions to date, has been a realisation that a bank should not be subject to standard corporate insolvency provisions. In the Isle of Man, there has been a further recognition of the need to comprehensively review our Insolvency legislation<sup>8</sup>. However that is a complex, longer-term exercise which extends far more broadly beyond the subject of bank insolvency. As an interim measure, Part Thirteen of the Bill sets out the proposed changes to existing insolvency arrangements for locally incorporated banks only, which are considered essential to an effective resolution regime. It is of note that a modified insolvency process already applies to Life Insurance undertakings in the Isle of Man.<sup>9</sup>

In summary, the first change proposed in the Bill seeks to require the Court to consult, and giving due consideration to the views of, the RA prior to making a decision on an application for the winding-up of a bank which is presented by any other party. This is to reduce the possibility of a shareholder or creditor of a locally incorporated bank successfully petitioning for a winding up order, which may be in contrast with a planned cross-border resolution action in which the RA might be involved.

The second proposed change is to modify the objectives of a bank liquidation, such that there is a higher priority accorded to ensuring that depositors who are covered under Deposit Compensation Scheme arrangements are repaid and secondarily, that the bank in liquidation provides such support services as may be required, to any purchaser or transferee to which all or part of the failed bank's business is moved. Thereafter, as in a standard corporate liquidation, the failed bank must be wound up for the benefit of its creditors as a whole.

The final proposed change is that, whilst the first two objectives of the liquidation remain relevant, a bank liquidation committee will be formed to oversee and liaise with the liquidator, consisting of representatives of the Treasury and the FSA only. Once those objectives have been satisfied, the bank liquidation committee will be disbanded and a conventional creditors' committee of inspection may be established.

#### PART FOURTEEN:

Part Fourteen deals with miscellaneous matters, specifically the making of regulations which may be required to support the new BRR primary legislation and arrangements for dealing with non-compliance therewith, as well as setting out the appeals process in relation to decisions of the RA.

#### SCHEDULE:

The Schedule sets out consequential amendments to the Preferential Payments Act 1908, relating to changes to the hierarchy of bank creditors in either a liquidation or 'bail-in' scenario. In such cases, the objective is to prioritise the rights of depositors to any repayment from the estate of the failed bank, over payments to other types of unsecured creditors of the bank, notably holders of any debt issued by the bank or its shareholders. At

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<sup>8</sup> See [https://consult.gov.im/treasury/the-collection-of-civil-debt/supporting\\_documents/The%20Collection%20of%20Civil%20Debt%20Phase%201v2.pdf](https://consult.gov.im/treasury/the-collection-of-civil-debt/supporting_documents/The%20Collection%20of%20Civil%20Debt%20Phase%201v2.pdf)

<sup>9</sup> See Schedule 3 of the [Insurance Act 2008](#).

present, if a bank fails and compensation is payable in respect of eligible protected deposits<sup>10</sup>, then a preference is given to those deposits irrespective of whether they are vested in the DCS. In future it is proposed that eligible protected deposits vested in the DCS, or in the DCS of another jurisdiction where an Isle of Man incorporated bank has a branch are given a higher level of preference than eligible protected deposits which are not vested in a DCS. Such deposits are however still preferred over other unsecured creditors of the failed bank. In addition, a new preference is also introduced for deposits which are in excess of the coverage limits of the DCS. The effect of these changes is to introduce a more tiered creditor hierarchy in the event of a bank failure, which will also assist with the potential operation of the 'bail in' stabilisation tool and the mitigation of potential claims from certain creditor classes under the 'no creditor worse off' safeguard set out in Part Ten of the Bill.

## **6. Questions or Feedback on the draft BRR Bill Consultation**

Feedback on any aspect of the Bill is welcomed and should be as specific as possible. Where relevant, the Part and Section of the Bill to which any given point relates, should be quoted. In addition, should you wish to disagree with any of the proposals set out in the draft Bill, please make your reasons for so doing clear. It would be particularly helpful if any counter-proposals could be contained in your response, where relevant.

## **7. Response Process**

The Treasury would welcome your views on these proposals through the consultation hub or by email to [treasuryconsultations@gov.im](mailto:treasuryconsultations@gov.im). The closing date for the receipt of comments is 13 December 2019. Postal responses can alternatively be submitted to:

John Coyle  
Senior Adviser – Bank Recovery and Resolution  
c/o Isle of Man Financial Services Authority  
P.O. Box 58  
Finch Hill House  
Douglas  
Isle of Man IM99 1DT

Following analysis of responses to this Consultation it is envisaged that the draft Bill will be finalised for subsequent introduction to Tynwald.

### **Confidentiality**

The information you send may be published in full or in a summary of responses.

When submitting your comments please indicate whether you are responding on behalf of an organisation (and if so which organisation) or on your own behalf.

Please let us know whether we can publish your comments in full (including your name or the name of the organisation you are representing), anonymously, or not at all (noting that if you select this option your response will only be part of a larger summary response document).

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<sup>10</sup> As defined in the Bill

All information in responses, including personal information may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2015 and the Data Protection Act 2018). If you want your response to remain confidential, you should explain why confidentiality is necessary and your request will be agreed to only if it is appropriate in the circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding.

All responses submitted will be held within the Isle of Man Government's consultation hub and will be treated in accordance with the [privacy policy](#).