



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

Sir William Cash
Chair
European Scrutiny Committee
14 Tothill Street
House of Commons
London
SW1H 9NB

14 February 2017

Dear Sir William

EM 14777/16, 14778/16, 14775/16 and 14776/16. On amendments to the Banking Recovery and Resolution Directive (BRRD) and the ranking of unsecured debt instruments in insolvency hierarchy and the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR).

Thank you for your report of 11th January on the CRD/CRR and BRRD package, following our Explanatory Memorandum of 20th December.

The negotiations for the Banking Recovery and Resolution Directive (BRRD) and the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) are being taken forward by the Maltese Presidency as a single package. I will therefore update you on all of these elements in this letter.

You asked to be informed of negotiating developments and to be told about the likely implementation dates of the proposals in the context of the Brexit date.

The Government has made clear to the Commission that we welcome the opportunity to implement important measures in line with internationally agreed minimum standards, such as the Leverage ratio and the Net Stable Funding Ratio (NSFR). We have also welcomed the commitment to proportionality for smaller firms and measures that will see capital requirements lowered for SME and infrastructure lending. These proposals are developing as set out in the EM.

At December ECOFIN, the Chancellor outlined our priorities for international harmonization, regulatory flexibility and proper scrutiny of the Intermediate Holding Companies (IHC) proposal. Official level working groups commenced in January and are ongoing. The main issues that have been discussed so far are:

- Pillar 2: we have supported flexibility for regulators as per our aims set out in the EM. Other Member States have been supportive of our positions.

- IFRS 9: As per the EM we support the introduction of an IFRS 9 transition phase and have pushed in negotiations for implementation before the end of 2017, prior to the entry into force of the new accounting standard. Council have agreed to take the IFRS 9 measures forward separately and on an expedited timeline, which is in line with our objective. Technical discussions on the shape of the transition will be taken forward in the coming months.
- Market Risk: We have not seen sufficient evidence to justify a substantial deviation from, or significant delay in the implementation of, Basel standards for Market Risk. The general view of others at Council has been supportive of the UK position.
- Other Basel requirements: Most Member States are broadly in support of implementing measures such as the leverage ratio, NSFR and large exposures measures in line with Basel standards.
- Intermediate Holding Companies: We have argued in the working groups and at ECOFIN that the new measure on Intermediate Holding Companies was included without proper scrutiny, and may be protectionist in a way that could impose costs on firms that are not appropriately justified by any resolution or financial stability benefits. The Commission are continuing to defend their proposal as a necessary measure to support resolution. The views of other Member States are mixed. We are continuing to conduct analysis of potential impacts and are engaging with counterparts on an ongoing basis.
- Remuneration: There is some support from other Member States for higher proportionality thresholds. In line with our concerns in the EM, we should continue to consider the impact of these proposals and the appropriate level of regulation for smaller firms.
- TLAC/MREL: As stated in the EM, we have argued it is important that the Financial Stability Board's Total Loss Absorbing Capacity (TLAC) standard is implemented fully and that the proposals do not impose constraints on the flexibility for the resolution authority to set an appropriate quality and quantity of loss absorbing debt to support a firm's resolution strategy. Currently, some of the Commission's proposals on minimum requirements for own funds and eligible liabilities (MREL) are maximum harmonizing and do not align with the FSB's TLAC standard; rectifying this is one of our key priorities in working groups. Some Member States are seeking a weaker standard.
- Large exposure requirement: As per the EM we support this measure, which aligns EU regulation with existing standards.
- Ranking of unsecured debt instruments in insolvency hierarchy: As mentioned in the EM, the Government and the Bank of England are considering the detail of the proposal to ensure it does not prevent the UK approach to structural subordination. Member States broadly supported the conceptual approach and fast tracking the directive, however Member States asked for consideration to be given to the transposition timetable.

The European Parliamentary groupings have now selected their rapporteurs, on CRDV/CRR2 - Peter Simons (DE, S&D) and on BRRD - Gunnar Hokmark (SE, EPP). We will provide further information on parliamentary timeframes and objectives when these emerge.

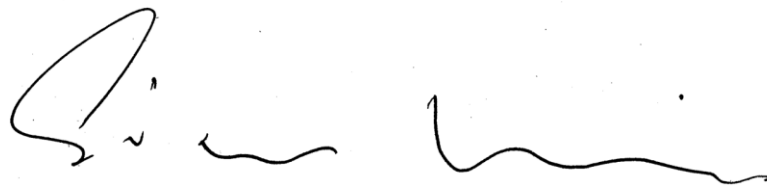
Based on the expected timeline of negotiations in and between Council and the European Parliament, and the completion of processes such as jurist linguists, we would envisage final legislative adoption of the package to take place no earlier than late 2018/early 2019. Entry into force and implementation timelines then vary depending on the measure, for example the NSFR proposal has a two year delay before implementation.

You asked for an assessment of the consequences for the UK of these proposals, in particular whether the Government's aim post-Brexit would be to be closer to the relevant international standards or the EU ones, if there were any divergence between the two.

The UK will be free to make its own choices on this matter post-withdrawal. The UK has always been a strong proponent and voice in international rule-setting fora, including Basel, and will continue to be so.

We are not able to speculate on UK rulemaking at some unspecified point in the future. The Government has already indicated that it intends to 'onshore' EU legislation into the UK system ready for Exit. This will be our focus in the medium term, alongside negotiations on the final EU/UK relationship.

I am writing in similar terms to Lord Boswell of Aynho, Chair of the House of Lords European Union Committee; and copying this letter to Eve Samson, Clerk to the Commons Committee; Chris Johnson, Clerk to the Lords Committee; John Turner, Clerk to the Lords Financial Affairs Subcommittee; Les Saunders, Department for Exiting the EU; Frances Milsom and Ross Turner, HM Treasury.

A handwritten signature in black ink, appearing to read 'Simon Kirby', written in a cursive style.

SIMON KIRBY
ECONOMIC SECRETARY TO THE TREASURY