Bail-out, bail-in: whose oar is it anyway? – The Bank (Recovery and Resolution) (Jersey) Law 2017

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The Bank (Recovery and Resolution) (Jersey) Law 2017 (the "**Law**") was passed by the Jersey States Assembly on 14 February 2017 and registered in the Royal Court on 12 May 2017, but it has yet to come into force.

What is the Bank (Recovery and Resolution) Law 2017?

The Law brings Jersey's banking legislation in line with changes made internationally in the wake of the 2008 global financial crisis – see the European Union's Bank Recovery and Resolution Directive 2014/59/EU (BRRD). The UK implemented that directive via its Banking Act 2009 and the Law means that Jersey remains in line with these international standards. The Law aims to:

- ensure the continuity of critical banking functions;
- avoid adverse effects on financial stability;
- minimise reliance on public financial support to failing banks; and
- protect covered depositors and clients' assets.

Essentially, the Law seeks to: (i) protect public funds (i.e. the taxpayer) by limiting reliance on government bail-outs; and (ii) protect bank customer deposits. Jersey will be able to assist a foreign jurisdiction where equivalent bank resolution action has been taken against an international bank that happens to also have a business in Jersey. It will also enable Jersey to intervene in the affairs of a failing local Jersey bank. Although no banks with a presence in Jersey failed during the financial crisis, the Guernsey branch of Icelandic bank Landsbanki did fail and customers of it lost a reported 8% of deposits.

To whom does the Law apply?

The Law applies to any person/entity registered to carry on deposit-taking business in Jersey under the Banking Business (Jersey) Law 1991 and to any Jersey company that is a subsidiary or holding company of such a deposit-taking business.

Resolution Authority

The Law establishes the Jersey Resolution Authority (the "**Resolution Authority**") and gives it a suite of tools for dealing with distressed or failing banks in Jersey. Those powers are aimed at protecting consumers and insulating the public purse, to some degree, from political pressure to bail out a failing bank.

The Resolution Authority has three guiding principles:

- reducing the risk to the public of financial loss due to a failing bank;
- protecting and enhancing the reputation and integrity of Jersey in commercial and financial matters; and
- the best economic interests of Jersey.

Once the Law comes into force, every Jersey bank will be required to have and submit a recovery plan to the Jersey Financial Services Commission (the "**Commission**") explaining what the bank intends to do in the event that its financial position deteriorates significantly and in particular, what actions the bank would take to restore its financial position. The Commission will then pass that plan to the Resolution Authority and the Resolution Authority will have an opportunity to comment on it and make recommendations.

The Resolution Authority has several tools it can deploy in pursuit of its guiding principles. They include:

- selling the bank's business to another bank or a new bank established by the Resolution Authority;
- separating failing assets from profitable assets by transferring the profitable assets to another entity; or
- applying the 'bail-in' tool to its shareholders and creditors.

What does 'Bail-in' mean?

'Bail-in' has become the shorthand moniker for the bank resolution idea. The bail-in provisions allow the Resolution Authority to cancel or write-down all or some of the liabilities owed by a failing Jersey bank and/or converts such liabilities into equity. Shareholders can have their shares cancelled or transferred to creditors that have been bailed-in. Creditors who are bailed-in have their positions written down or written off and potentially converted into equity as part of efforts to stabilise a bank.

Importantly for customers of the failed bank (and employees), liabilities such as covered deposits and salaries are excluded from these bail-in provisions, as are secured liabilities; liabilities of the bank as fiduciary; and tax and social services liabilities.

Mandatory bail-in statement in contracts

Banks must state in each document governed by foreign law to which they are party that the bank could be made the subject of bank recovery and resolution measures pursuant to the Law. This is intended to warn counterparties about the potential powers of the Resolution Authority to modify their contractual rights against the bank. The "bail-in clause" (embodying the requirement for 'Contractual recognition of bail-in') requires the counterparty to: (i) recognise that the bank's obligations and liabilities may be subject to the Resolution Authority's exercise of the write-down or conversion powers; and (ii) agree to be bound by the exercise of such powers by the Resolution Authority.

The Bank Resolution Fund

In order to fund the work of the Resolution Authority, the Law establishes a fund into which Jersey-registered banks are required to pay an annual administration levy and may also be required to make contributions to the Resolution Authority to fund its work up to a maximum aggregate sum (currently) of £100m in any 5 year period. The Resolution Authority is also permitted to borrow.

Impact on the market

The Law will provide greater protection for depositors and the taxpayer. However it is unclear how much of these costs might ultimately be passed on to customers. Contracts entered into by the banks under foreign law will need to have contractual recognition of bail-in provisions. Banks will also be required to formulate and update and maintain the statutorily-required recovery plan.

Should you require any advice in respect of bail-in, bank stabilisation and recovery measures, please contact your usual Carey Olsen contact, or a member of the team below.

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