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Resolution in the UK post-Brexit – onshoring the Bank Recovery and Resolution Directive

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The Brexit engines at HM Treasury, the FCA, PRA and Bank of England are responding admirably to the challenge posed by Brexit to ensure that the UK has a continuing, robust and effective legal regime once the currently applicable body of EU laws no longer automatically formpart of domestic legislation. Although we continue to hope that agreement is reached on the future relationship between the EU and UK, the authorities must prepare for a "hard Brexit", that is a Brexit in which there is no implementation or transitional period agreed and no equivalence.

Detail around the regime for the resolution of banks, building societies, investment firms and certain group companies (for convenience, referred to together in this briefing as **banks**) under English law following a hard Brexit has recently emerged. Whilst the BRRD's policy drivers will remain central to the UK framework, the correction of a number of "deficiencies" in the ruleset post-Brexit may trigger additional procedural burdens and legal uncertainty for firms operating in the UK.

If I'm compliant with the BRRD now, will I not be ok?

In short, not entirely. Although the intention of the BRRD SI is to onshore the BRRD with as little change as possible to ensure the continued functioning of UK law, there are a number of issues that arise from correcting the "deficiencies" in the Banking Act once the UK is no longer part of the EU. These include:

- the redrawing of recovery group lines, leading to questions such as whether new UK specific recovery plans will need to be written before 29 March 2019?
- Requirements for UK banks to include contractual recognition of bail-in provisions and contractual recognition of stays in certain EEA law governed agreements (for EU27 banks, the requirement to include contractual recognition of bail-in provisions in certain English law governed agreements going forward will also be important); and
- UK banks may also not be able to count debt which would otherwise be eligible towards their minimum requirement for own funds and liabilities to the extent it doesn't contain contractual recognition of bail-in provisions.

What changes are being proposed?

One of the standard 'deficiencies' HM Treasury and the regulatory authorities are tasked with correcting as they 'nationalise the aquis' is the treatment of EU member states post-Brexit. EU member states will no longer receive preferential treatment but rather will be treated in UK legislation in the same way as other third countries. References to third countries should accordingly be read to include all EEA member states.

Recognition of EU resolution actions

One consequence of this relates to the recognition of resolution actions, currently automatically recognised between EU member states¹. Post-Brexit, the UK would extend its third country recognition framework, which applies to third country resolution actions that are broadly comparable in objectives and resolution actions taken under the UK regime, to include EU-led resolutions. This would mean that EU-led resolutions should be recognised by the UK unless doing so would be contrary to relevant UK statutory safeguards.

Notwithstanding the likelihood of continued recognition in practice, the loss of automatic recognition of EU resolution actions has consequences for EU27 banks. In particular, such banks may not be able to count English law governed is sued debt which would otherwise be eligible towards their minimum requirement for own funds and liabilities (MREL)² (please see 'Brexit: Recognition of Resolution Actions' published as a joint paper with AFME). The SRB's 2018 MREL policy for the first wave of resolution plans states that the SRB will address on a case-by-case basis the possible effect of Brexit on the stock of MREL-eligible instruments but that banks are expected to include contractual recognition clauses in new is suances and must be prepared to demonstrate that the decisions of the SRB will be effective. Additionally, agreements governing liabilities of EU27 banks and which are governed by English law may have to include contractual recognition of bail in provisions and, going forward, contractual recognition of stays³ in certain circumstacnes.

For UK banks, the same is sues arise for EEA law governed liabilities. We discuss the PRA's and FCA's individual approaches to these requirements in respect of EEA law governed instruments below.

Cooperation with other EU authorities

UK regulators are currently required to follow operational and procedural mechanisms set out in the BRRD to cooperate with other EU authorities. This includes the UK's participation in European resolution colleges, joint assessment and decision-making between UK and EU regulators. Once the UK leaves the EU, the BRRD would no longer apply to the UK and the BRRD SI therefore removes these mechanisms from the UK regime. References in UK legislation to EEA authorities should continue only to the extent that third country authorities are in scope of the particular reference.

Such changes to the UK regime would not prevent the UK regulators from cooperating with EU regulators and authorities. UK authorities would continue to be able to share information with the EU in the same way as with third countries. Indeed, in CP25/18, the Bank of England and PRA confirm that although obligations to participate in EU supervisory colleges and to take joint decisions with other EU regulators are removed post-Brexit, the UK regulators will continue to support supervisory co-operation with third countries. By way of example, the authorities intend to continue to host and participate in global supervisory colleges and crisis management groups for global systemically important banks. This will be done in reliance of existing FSMA provisions⁴.

Contractual recognition of bail in

The existing PRA rules on the contractual recognition of bail-in require firms to include in third country law contracts governing certain liabilities a termby which the creditor or party to the agreement recognises that the liability may be written down or converted by the Bank as the UK resolution authority. The rules require firms to comply with the

⁴ For example Section 169A FSMA.

¹ Under the Credit Institutions Winding-Up Directive.

² This is clear under the current proposals for BRRD II.

³ Under the proposed Article 71a of the Council's general approach in respect of the Commission's BRRD II proposals.

requirement in respect of liabilities created or materially amended after Thursday 31 December 2015 (or after Thursday 19 February 2015 for liabilities under debt instruments).

The PRA have identified the rules around contractual recognition of bail in and contractual stays in resolution as necessary to ensure orderly resolution and as such, for the most part, not appropriate for the application of any temporary transitional relief post-Brexit. However, the PRA proposes to clarify that the requirement does not generally apply in respect of EEA law governed liabilities that were created before exit day. Firms will need to comply in respect of new EEA law governed liabilities created after exit day or any EEA law governed liabilities which are materially amended after exit day. But firms 'existing stock of EEA law governed liabilities at exit day would not need to be updated under the proposal (unless materially amended post-Brexit).

To the extent that a firm has existing EEA law governed liabilities or instruments which might constitute a substantive impediment to resolution, the Bank may use its power of direction to direct the firm to ensure that any decision by the Bank to write-down or convert the liability or instrument concerned would have effect. This could include a direction to re-negotiate the liability to include a contractual recognition clause.

Although the PRA does not propose to grant transitional relief in respect of liabilities that are intended to count towards a firm's MREL, the PRA does offer some relief. The PRA proposes to delay the obligation to include a contractual recognition of bail-in termin new or materially amended EEA law governed phase two liabilities ⁵ after exit day. Whilst the existence of relief is welcome, firms with EEA law governed documentation governing master agreements or account terms will need to consider making amendments given that new transactions post-Brexit will amount to material amendments.

The FCA has recently consulted on proposed changes to its rules on contractual recognition of bail in and its approach is in practical terms much the same as the PRA. See further the Background section of this briefing, below.

Stay in Resolution

The PRA rules on Stay in Resolution aim to ensure that a firm's entry in resolution does not, by itself, trigger contractual early termination rights or other rights under a contract that are normally triggered by a default. The PRA rules require firms to include in new financial arrangements (or materially amended existing financial arrangements) which are governed by third country law, a contractual recognition termunder which the counterparty agrees to restrictions on their early termination and security enforcement rights similar to those that would apply if the financial arrangement were governed by the laws of any part of the UK.

As discussed above, the PRA have identified the rules around contractual stays in resolution as necessary to ensure orderly resolution and, as such, not appropriate for the application of any temporary transitional relief post-Brexit. However, the PRA clarifies that the requirement will not apply in respect of EEA law governed financial arrangements that were created before exit day. Firms will be required to comply with the rules in respect of new EEA law governed financial arrangements after exit day. The existing stock of financial arrangements governed by EEA law at exit day would not need to be updated unless and until materially amended after exit day: this may pose challenges in the context of EEA law governed master agreements, where entering into a new trade would amount to a material amendment.

Again, where a particular firm has existing EEA law governed financial arrangements which might constitute a substantive impediment to resolution, the Bank may use its power of direction to require the firm to remove the impediment, for example by requiring the inclusion of a contractual recognition term in those arrangements even where they existed before exit.

Creditor hierarchy

The BRRD SI creates a structural mismatch between the UK and EU creditor hierarchies. Under the proposed new UK regime, only deposits covered by the UK Financial Services Compensation Scheme will be 'covered deposits', as opposed

⁵ Unsecured liabilities that are not debt instruments.

to all deposits protected by any EEA deposit guarantees cheme. The ranking of deposits made through EU branches of UK branches will be aligned with the ranking of deposits held by third country branches of such banks. The consequences of this are material to the scope and order of the bail in tool.

Recognition of EU FMIs

The BRRD contains a number of exclusions for EU financial market infrastructure (**FMI**). These are removed by the BRRD SI. This means that short termliabilities arising from participating in settlement systems will only be excluded from bail in and the requirement to include contractual recognition provisions where the settlement system is designated under the UK Settlement Finality Regulations. Similarly, persons designated as settlement systems by an EU27 member state and EEA CCPs will no longer qualify as excluded persons for the purposes of the temporary stay power and PRA contractual recognition of stay rules. Any third country CCP (including now EEA CCPs) has to be recognised by the Bank of England under the UK's on-shoring of the European Market Infrastructure Regulation. There are as yet no such recognised third country CCPs.

As the FMLC writes in its report on issues of legal uncertainty arising in the context of the changes made by the BRRD SI, "[s]hould U.K. banks be permitted to continue to conduct securities settlement and clearing with European systems and CCPs, the removal of the protections against stays in respect of E.E.A. CCPs could possibly have unintended market-wide consequences."

The draft Financial Markets and Insolvency (Amendment and Transitional Provision) (EU EXIT) Regulations 2018 propose a temporary designation regime for EEA systems which currently benefit from UK protections. This regime will last for three years but can be extended by regulation by HM Treasury. Existing EEA systems will be required to notify the Bank of England before exit day and, following exit day will have six months to make a full application under the revised Settlement Finality Regulations. The effect of this would be to allow those EU systems that are currently designated to benefit from continued protection in respect of their UK participants, until such time as they may have been granted a permanent designation. Similarly, the draft Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 provide the Bank of England with powers to receive applications (both in advance of, and after, the UK's withdrawal from the EU) as well as to assess and make decisions on the recognition of non-UK CCPs, with any decisions then taking effect when the UK leaves the EU⁶. The SI also establishes a temporary recognition regime for non-UK CCPs. This regime will allow eligible non-UK CCPs to continue providing clearing services in the UK for up to three years, extendable by HM Treasury. CCPs in the regime that have not already submitted a formal application for recognition must do so within six months of exit day.

The European Commission's November 2016 proposals to amend the BRRD (**BRRD II**) include extensions of the BRRD exclusions to also cover third country CCPs recognised by ESMA. It is also understood that the European authorities have agreed to include a review clause whereby the Commission will assess the existence of any gaps in the protection offered by the Settlement Finality Directive⁷ 24 months after entry in force of BRRD II.

Recovery and Resolution plans

The Bank of England will have sole responsibility for drawing up resolution plans and determining MREL for groups subject to consolidated supervision in the UK after the UK leaves the EU.

When looking at the workings of the on-shored BRRD, it is also relevant to consider the changes to the scope of consolidation and 'group' under the on-shored Capital Requirements Regulation⁸. These changes may also affect recovery and resolution groups and the scope of planning required.

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⁶ Recognition of a CCP also requires that a) Treasury has made regulations determining equivalence of the legal and supervisory arrangements of a the home regime; b) the CCP is subject to effective supervision and enforcement in their home jurisdiction; c) cooperation arrangements have been established with the relevant competent authorities; and d) the CCP is not established in a country that is a high-risk third country within the meaning of regulation 33 of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017(1).

Directive 98/26 on settlement finality in payment and securities settlement systems

⁸ The Capital Requirements (Amendment) (EU Exit) Regulations 2018

In practice, this means that firms which have been required to produce group-wide recovery plans, and resolution planning information packs, for their EU and UK entities may in future need to produce additional plans whether for their UK or EEA sub-group or their UK or EEA entity on a stand-alone basis.

Cross references to EU legislation

The BRRD SI copies across references to the BRRD and other EU legislation to retain key concepts under UK law that would otherwise be lost. This is intended to avoid changing underlying policy drivers. References will be to the UK legislation that transposed the relevant provisions or the relevant onshored regulation or technical standards as amended in order to correct deficiencies arising from Brexit. It should be noted that cross references to the EU Capital Requirements Regulation, the EU Market Abuse Regulation and the European Market Infrastructure Regulation are to such regulations as they have effect on the day on which the BRRD SI is made (rather than the day on which the UK leaves the EU).

References to "resolution financing arrangements" in Commission Delegated Regulation 2016/1450 are replaced with cross references to UK legislation concerning resolution financing (from the bank levy).

This approach is consistent with that taken across all of the Brexit related SIs but will result in complexity for future readers of BRRD related legislation, particularly as cross-references will remain static whilst the actual EU legislation will no doubt continue to evolve.

References to EU replaced with references to UK

One consequence of amending references to the EU is that references to the Bank of England's obligation to consider the economy, financial markets, financial system and/or financial stability of EEA states when carrying out its resolution actions should be read as simply an obligation to consider such elements of the UK only.

Practical comments

Treating EU member states as third countries across the BRRD framework has number of consequences. Although the PRA and Bank of England intend to "continue to support supervisory co-operation", the UK's seat at the table will be subject to invitation. That said, the European Commission's communication "Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan" does state that the European Supervisory Authorities are encouraged to start preparing cooperation arrangements with UK supervisors to ensure that exchange of information related to financial institutions and actors is possible immediately after exit date in the case of a no deal scenario.

Similarly, although the SIs are not intended to effect policy changes, Brexit has wider implications on cross-border resolution such as the structural mis match created by the preference of UK depositors over third country deposits in the creditor hierarchy.

The industry has also requested engagement and consultation to assess the potential impacts on financial stability arising from the consequences of removing automatic recognition between the UK and EU27 of their respective resolution actions. The SRB has published a position paper on its expectations to ensure resolvability of banks in the context of Brexit which discusses the implications of UK law becoming a third country law on stocks of MREL. The SRB has indicated that a case by case analysis will be required, such that the treatment of the existing stock of UK law governed instruments remains uncertain.

Questions also remain around the impact of changes to the scope of consolidation and groups in the UK capital requirements legislation post-Brexit. Will new recovery and resolution plans be required of cross-border groups? If so, by when? Will plans which have been agreed by the European resolution colleges be 'grandfathered' or will they have to be revisited?

⁹ Chapter 11 of HMT's 2017 'Banking Act 2009: special resolution regime code of practice'.

Additionally, we do not yet know how HM Treasury intends to implement BRRD II which will be "in-flight" at the point of a hard Brexit.

So what should I do?

Firms should review their policies around including contractual recognition of bail-in and contractual stay provisions in agreements in light of the changes.

The FCA and PRA are keen to ensure an orderly implementation of the changes required by Brexit and to understand where compliance would be challenging for firms. You should discuss with your regulator any areas which you anticipate struggling to implement before Brexit. This may include discussing expectations around recovery and resolution plans and reviewing playbooks.

The legal bits

The UK resolution framework

The Banking Act 2009 established the UK's Special Resolution Regime (**SRR**), providing the UK regulatory authorities with tools to protect financial stability by effectively resolving banks, building societies, investment firms and other entities that are failing or likely to fail, while protecting taxpayers, depositors and the economy.

The Bank Recovery and Resolution Directive (2014/59/EU) (**BRRD**) introduced an EU wide framework for the recovery and resolution of EU credit institutions and significant investment firms that were failing or likely to fail. It sought to provide national authorities with harmonised powers to tackle financial crises in banks and investment firms. The BRRD also established mechanisms for co-operation between resolution authorities in applying resolution tools and powers to financial groups operating on a cross-border basis.

The Banking Act 2009 was amended in 2015 to implement the BRRD via a number of statutory instruments.

On 23 October 2018 the Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018 (BRRD SI) were laid before Parliament. The BRRD SI seeks to ensure that the UK's SRR works legally and practically once the UK has left the EU. The BRRD's policy drivers will remain central to the framework, ensuring continuity and certainty on Brexit. The BRRD SI assumes that there will be no cooperation with EU authorities. The changes in the SI will not take effect on 29 March 2019 if a transitional agreement is reached.

Directive 2001/24 on the reorganisation and winding up of credit institutions established an EEA wide framework for the reorganisation and winding up of EEA banks, building societies and credit unions. Under the Directive, the administrative or judicial authorities of the Member State where an institution is authorised (the "home Member State") are granted exclusive jurisdiction for the reorganisation and winding up of credit institutions and their branches across the EEA. The Directive also ensures that other Member States automatically recognise the action (including resolution action) taken by the home Member State. The Directive was transposed into UK law in the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (S.I. 2004/1045) which prevent a UK court from making winding up or reorganisation measures in respect of EEA credit institutions and provide that an EEA insolvency or resolution is automatically recognised in the UK. The draft Credit Institutions and Insurance Undertakings Reorganisation and Winding Up (Amendment) (EU Exit) Regulations 2018 were published on 30 November 2018. HM Treasury's approach under this SI is to remove the provisions in UK law that provide for the reciprocal arran gement with EEA Member States including the automatic recognition of EEA resolution action.

The regulatory ruleset

Under the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 approved by Parliament on 26 October, HM Treasury delegates' responsibility for fixing deficiencies arising in onshored Binding Technical Standards to the UK regulators. Responsibility for BTS adopted by the European Commission pursuant to the BRRD rests with the Bank of England where they concern resolution, and with the PRA and/or the FCA where they concern supervisory responsibilities.

Changes proposed by the authorities are intended to be in line with and based on the relevant SI produced by HM Treasury (in this case the BRRD SI). As with the changes made by the SI, the changes to the regulatory rules et proposed by the authorities will not take effect at 11:00pm on Friday 29 March 2019 if the implementation period is ratified. If an implementation period commences on 29 March 2019, the changes will take effect after the end of such period and further modifications may be necessary to reflect any agreement reached on the future relationship between the EU and UK.

The PRA's approach

On 25 October 2018 the PRA published CP26/18¹⁰ which contains information on the PRA's approach to the BRRD BTS for which it is responsible. CP26/18 is intended to be read together with CP25/18 published jointly by the PRA and Bank

 $^{^{10}}$ Updated on 2 Nov ember to include technical standards relating to the Financial Conglomerates Directive .

of England on The Bank of England's approach to amending financial services legislation under the European Union (Withdrawal) Act 2018 (the temporary permissions regime aspects of which are discussed in a separate briefing). The two consultations run until 2 January 2019.

CP25/18 also sets out the Bank of England and PRA proposals for using the temporary transitional power outlined by HM Treasury on 8 October. The Bank and the PRA expect to use the power "in such a manner that would ensure that firms and FMIs providing services within the Bank's and PRA's regulatory remits do not generally have to prepare now to implement changes by exit day" and are "considering exercising the transitional powers in a broad way" with certain limited exceptions. Two out of the three exceptions identified by the PRA at this stage relate to elements of the PRA's rules on contractual recognition of bail in rules and contractual stays in resolution (as discussed above). The PRA is also still considering the duration of the transitional relief allowed.

The Bank of England's approach

On 25 October 2018 the Bank of England published a resolution consultation paper which sets out changes to binding technical standards in relation to resolution. It also indicates how firms should interpret existing Statements of Policy on resolution in light of any deficiencies arising from the UK's withdrawal from the EU. This consultation also runs until 2 January 2019.

The Bank of England does not propose to update its three resolution statements of policy¹¹ in advance of exit day but they will be "reviewed and updated in due course". They will continue to apply after Brexit but should be interpreted consistently with general principles set out in CP25/18.

Readers of the consultation are told to take into account the regulators' temporary transitional powers when considering the proposals.

The FCA approach

The FCA released CP 18/36 on 23 November 2018, in which it consults on its approach to many of the BTS for which it is responsible. However, CP 18/36 does not address any BTS in respect of the BRRD. Further consultation is expected in due course. The FCA will direct stakeholders to the amendments to the shared BRRD BTS in CP 26/18.

CP 18/36 does address the FCA's proposed changes to IFPRU 11.6.3 R, setting out the FCA's contractual recognition of bail-in requirement. The FCA proposes to apply the requirement to liabilities governed by the law of an EEA state is sued or entered into, or materially amended, after exit day.

Guidelines and Recommendations

Guidelines and Recommendations is sued by the European Supervisory Authorities are not saved by the European Union (withdrawal) Act 2018. Notwithstanding this, the Bank of England expects firms to continue to comply with the Guidelines and Recommendations that applied before exit, to the extent that they remain relevant. This includes Guidelines is sued by the EBA in relation to resolution. Firms should interpret Guidelines and Recommendations which remain applicable to them in light of on shoring changes made to relevant legislation.

The Bank and the PRA may revisit their approach to Guidelines and Recommendations after exit.

$Code\ of Practice$

HM Treasury also intends to update the Special Resolution Regime Code of Practice to provide further clarity on the BRRD SI's amendments to the UK's SRR.

BRRDII

On 23 November 2016 the European Commission published a package of proposals often referred to as either the Banking Reform Package or the Risk Reduction Measures. This package includes two directives which amend the BRRD.

¹¹ The Bank of England's power to direct institutions to address impediments to resolvability; The Bank of England's approach to setting MREL within groups and further issues; and The Bank of England's policy on valuation capabilities to support resolvability.

Directive 2017/2399 on the ranking of unsecured debt instruments in insolvency hierarchy was published in the Official Journal on 27 December 2017. Trilogues on the second directive amending the BRRD (referred to as BRRD II) on November 21 and 22 resulted in the agreement of a number of key is sues. It remains subject to technical and legal translation revision and there are still a number of outstanding is sues (e.g. remuneration, off-balance sheet guarantees to collective investment undertakings, treatment of shadow-banking or market based finance) which have to be addressed. It is anticipated that BRRD II will be adopted and published in the Official Journal in the first few months of 2019, with national implementation to take place within 18 months (i.e. likely Q3 2020).

On 22 November, the Financial Services (Implementation of Legislation) Bill received its first reading in the House of Lords. The Bill provides the power, in a no-deal scenario, for the UK to implement and make changes to a specified list of 'in-flight files.' These are pieces of European Union financial services legislation agreed or in negotiation at the point of exit, with implementation dates falling in the two years after exit and in respect of which the UK played a leading role in shaping. BRRD II is one of the specifically listed pieces of such "in-flight" legislation captured by this Bill.

Subject to certain safeguards, the Bill provides the Government with the power to choose to implement only those EU files, or parts of those files, which are both appropriate and beneficial for the UK and adjust and improve the legislation as it is brought into UK law to ensure that it works better for UK markets. It therefore remains to be seen how HM Treasury might implement BRRD II.

Legislation amended by the BRRDSI

UK legislation amended	Retained but amended direct EU legislation
The Banking Act 2009	Commission Delegated Regulation (EU) 2016/778 of 2 February 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary ex post contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines
The Insolvency Act 1986	
The Financial Services (Banking Reform) Act 2013	
The Bank Recovery and Resolution (No.2) Order 2014	
The Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations 2009	
The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009	
The Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014	
The Banking Act 2009 (Banking Group Companies) Order 2014	Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms
The Bank Recovery and Resolution Order 2014	
The Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations 2014	
The Banking Act 2009 (Restriction of Special Bail-in Provision, etc.) Order 2014	Revoked direct EU legislation
The Building Societies (Bail-in) Order 2014	Commission delegated regulations 2015/63, 2016/1434 and 2017/867
The Bank Recovery and Resolution Order 2016	

Your Allen & Overy contacts



Partner Financial Services Regulatory +44 203 088 2582 bob.penn@allenovery.com



Partner Financial Services Regulatory +44 203 088 2495 damian.carolan@allenovery.com



Kate Sumpter Partner Financial Services Regulatory +44 203 088 2054 kate.sumpter@allenovery.com



Nick Bradbury Partner Financial Services Regulatory +44 203 088 3279 nick.bradbury@allenovery.com



Etay Katz Partner Financial Services Regulatory +44 203 088 3823 etay.katz@allenovery.com



Kelesi Blundell Senior Associate Financial Services Regulatory +44 203 088 2089 kelesi.blundell@allenovery.com



Andrzej Wieckowski Senior Associate Financial Services Regulatory +44 203 088 2357 andrzej.wieckowski@allenovery.com



Kirsty Taylor Senior PSL Financial Services Regulatory +44 203 088 3246 kirsty.taylor@allenovery.com



Oonagh Harrison Senior PSL Financial Services Regulatory +44 203 088 3255 oonagh.harrison@allenovery.com

If you would like to discuss the issues raised in this paper in more detail, please contact any of the experts above or your usual Allen & Overy contact.

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