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## BRRD2 transposition in the Czech Republic

On 27 January 2021, the Czech Chamber of Deputies adopted at its first hearing an amendment to the Czech Crisis Resolution Act<sup>1</sup> and other acts which aims to transpose the BRRD2<sup>2</sup> framework into Czech law (the "**Amendment**"). The Amendment is currently entering scrutiny at a second reading at the Czech Chamber of Deputies, which started on 13 April 2021.

As the transposition date of the BRRD2 was set for 28 December 2020, and this transposition date has not yet been met, it is expected that the Czech Parliament will expedite the legislative process to ensure transposition of the BRRD2 into Czech law as soon as possible.

Below is a summary of the major points brought by the BRRD2 and the Amendment.

### BRRD2

BRRD2 was published in the Official Journal of the European Union on 7 June 2019 and entered into force on 27 June 2019. BRRD2 makes amendments to the original BRRD directive from 2014 in order to reflect the EU's updated resolution policy requirements and minimum requirement for own funds and eligible liabilities (MREL)<sup>3</sup>.

BRRD2 aims to implement the Financial Stability Board's<sup>4</sup> total loss absorbing capacity (TLAC) standard by revising the aforementioned MREL regime with intention to align the MREL requirements with the TLAC standard.

Apart from the capital requirements framework, BRRD2 harmonises resolution mechanisms and provides for specific rules in the area of group resolutions<sup>5</sup>.

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1 Act No. 374/2015 Coll., Crisis Resolution Act.

2 Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC

3 MREL stands for the minimum amount of equity and debt that a financial institution needs to maintain to absorb losses and provide for recapitalisation, if a resolution of a financial institution took place.

4 The Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system.

5 "Resolution" means the restructuring of a financial institution (typically a bank) by a resolution authority through the use of defined resolution tools.

Following extensive discussions at the level of EU regulators about suitability and the offering of subordinated debt instruments to the retail public, BRRD2 also provides for a legal framework which regulates the offering of subordinated debt instruments to non-professional (retail) investors.

## BRRD2 transposition in the Czech Republic and MERL targets

The updated BRRD2 resolution framework will be transposed by the Amendment into the Czech Crisis Resolution Act, as the resolution process under Czech law is governed primarily by this act.

The implementation and enforcement of the updated crisis resolution rules under the BRRD2 framework will lie with the Czech National Bank ("CNB"), which is the Czech crisis resolution authority.

CNB has already established intermediate MREL targets for most of the respective Czech financial institutions. While the final MREL target needs to be met by Czech financial institutions by 1 January 2024, intermediate MERL targets need to be met by 1 January 2022.

## Moratorium

The Amendment provides CNB with new authority, a so-called "moratorium" power. CNB will be entitled to freeze payment and delivery obligations of a financial institution in the case of a resolution and also if a resolution of a financial institution may be expected.

The purpose of this moratorium is to allow the CNB to establish whether a resolution action is in the public interest, to choose the most appropriate resolution tools or to ensure the effective application of one or more resolution tools.

The duration of this suspension (moratorium) will be limited to a maximum of two business days. This period is a compromise, as it was initially proposed during the BRRD2 approval discussion process that the suspension period could reach up to five business days.

The "moratoria" power is an important new concept and a powerful new tool for the CNB, yet it will remain to be seen how it will be used in practice.

## Offering of subordinated eligible liabilities

In light of recent insolvencies of Italian banks, there was an extensive debate at the EU level regarding the permissibility of the offering of subordinated instruments issued by banks to retail clients. Subordinated banking instruments (subordinated eligible liabilities) are unsecured instruments and rank below other, more senior loans or securities. The riskiness of these instruments depends solely on the quality of the relevant issuer's assets and on the amount of loss-protection provided by equity and subordinated notes. Needless to say, this protection may not be sufficient for retail investors.

The Amendment provides that a seller of these instruments will be required to ensure that retail investors who are interested in buying these instruments will pass the "suitability test", which is

provided under the Czech Capital Markets Act<sup>6</sup> which has transposed this MIFID II<sup>7</sup> concept into Czech law.

The suitability assessment will need to consider that subordinated instruments match the client's investment objectives, financial situation, knowledge and experience. Suitability test requirements are extensively elaborated by the ESMA<sup>8</sup> as part of its supervisory oversight of MIFID II framework.

Stricter requirements are further stipulated in the case of retail investors whose portfolio does not exceed EUR 500,000. In this case, the overall exposure of investments into subordinated instruments may not exceed 10% of the investment portfolio of such retail investors. In the case of retail investors whose portfolio does not exceed EUR 500,000, the initial investment into one or more subordinated instruments will need to be in the minimum amount of EUR 10,000.

### Effective date of BRRD2 transposition

Although an exact date of the BRRD2 transposition into Czech law has not been set, it can be expected that the BRRD2 regime will be transposed in the Czech Republic during the second half of 2021.

It is thus advisable to assess if current processes and procedures at banks are in line with the BRRD2 legal framework. Entities offering investments into subordinated instruments should pay special attention to the limitations to offer investments into these instruments to retail investors.

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<sup>6</sup> Act 256/2004 Coll., Capital Markets Act, as amended.

<sup>7</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

<sup>8</sup> The European Securities and Markets Authority.

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