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Comments on Part 2 (Bank Insolvency) and Part 3 (Bank Administration) of the Banking Bill

The City of London Law Society (CLLS) represents over 13,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. The comments (as set out below) on the Banking Bill (regarding bank insolvency and bank administration for a failing bank or building society) have been prepared by the Insolvency Law Committee. The Committee is made up of a number of solicitors from City of London firms who are expert in their field. The Committee's purpose is to represent the interests of those members of the CLLS involved in the insolvency law area. The Committee's comments are on the form of the Banking Bill as amended in the Public Bill Committee and ordered to be printed on 4 December 2008. Members of the working party (listed in Schedule 2 of this submission) will be glad to amplify any comments if requested.

1. We refer you to our response to the January consultation paper entitled Financial Stability and Depositor Protection: Strengthening the Framework and to our response to the July consultation paper entitled Financial Stability and Depositor Protection: Special Resolution Regime (together the **Responses**). We have enclosed copies of these Responses at Schedule 1 to this submission for your convenience. In these responses we queried the need for special insolvency procedures to deal with a failing or failed bank in light of the proposed changes to the Financial Services Compensation Scheme (the **FSCS**) which, in our view, would achieve many of the expressed objectives of protecting depositors and enhancing public confidence. We expressed the view that the existing corporate insolvency procedures would be perfectly adequate for dealing with an insolvent bank, particularly in view of the pre-insolvency tools and other changes to the regulatory and legal regime that were being proposed. We also expressed serious concerns regarding the impact that such special procedures could have on legal certainty, investor confidence and the international

arena (particularly in the context of cross-border recognition as discussed below). We still stand by those earlier comments and concerns which we do not propose to repeat in this letter. This letter should therefore be read in conjunction with the Responses.

2. Whilst we believe that there are important issues to be debated in relation to the Special Resolution Regime (particularly in the context of partial transfers of assets and/or liabilities), we do not propose to deal with those issues in this letter. Instead we have focussed on Part 2 and Part 3 of the Banking Bill, relating to bank insolvency and bank administration.

Cross-border recognition of special insolvency proceedings

5. As a general comment, and for the reasons given below, we have concerns as to whether the bank insolvency and bank administration procedures would be recognised as insolvency proceedings for the purposes of the relevant cross-border legislation including, in particular, the UNCITRAL Model Law on Cross-Border Insolvency (the **Model Law**) and Directive 2001/24/EC on the reorganisation and winding up of credit institutions (the **Winding Up Directive**).

6. The Model Law provides for the recognition of certain types of "foreign proceeding". This is defined as "a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation". Paragraph 23 of the Guide to Enactment of the Model Law states that, to fall within the scope of the Model Law, a foreign insolvency proceeding needs to possess certain attributes including basis in insolvency-related law of the originating State; involvement of the creditors collectively; control or supervision of the assets and affairs of the debtor by a court or other official body; and reorganisation or liquidation of the debtor as the purpose of the proceeding. Ultimately the types of foreign proceeding that will be recognised under the Model Law will depend on the implementing legislation in the relevant country in which recognition is sought. Assuming, however, that such implementing legislation uses a similar definition of foreign proceeding to that used in the Model Law, it is not clear whether bank insolvency or bank administration under the Banking Bill would satisfy such a definition. In the case of bank insolvency, it could be argued that it is not collective procedure for all the creditors generally but is primarily intended to protect eligible

depositors. However, as the ultimate aim (subject to the overriding objective of protecting eligible depositors) is to wind up the affairs of the bank, on balance, we consider that this procedure would be recognised as a foreign proceeding under the Model Law. In the case of bank administration, however, the purpose is not to reorganise or liquidate the residual bank but rather to support the commercial purchaser or bridge bank to which the assets and liabilities of the residual bank have been transferred. Furthermore, it is difficult to see how this is a procedure involving the creditors collectively. We therefore have real doubts as to whether this procedure would be recognised as a foreign proceeding under the Model Law[1].

7. The Winding Up Directive relates to winding-up proceedings and reorganisation measures in respect of an EEA credit institution. It provides for a single set of such proceedings in the EEA, to be commenced in the "home" Member State, and for the automatic recognition of the effects of such proceedings throughout the EEA (subject to certain specified exceptions). Winding-up proceedings are defined as "collective proceedings opened and monitored by the administrative or judicial authorities of a Member State with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other, similar measure". Reorganisation measures are defined as "measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims". Assuming that the Member States of the EEA have used similar definitions in their domestic legislation implementing the Winding Up Directive, the question arises as to whether the bank insolvency procedure is a "winding-up proceeding" and bank administration is a "winding-up proceeding" or "reorganisation measure" for the purposes of the Winding Up Directive. Again, this is not clear. In the case of bank insolvency, it could be argued that the proceeding is not a collective one for the creditors generally (because the protections for eligible depositors are given priority) but, on balance, we consider that the procedure would be treated as a winding-up proceeding as the ultimate aim is to realise assets under the authorities of the court and the Bank of England. In the case of bank administration, however, the

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1 By analogy, we note that no attempts were made by the three Icelandic banks to seek recognition, under Chapter 15 of the US Bankruptcy Code (which implements the Model Law into US bankruptcy law), of the appointments of the receivership committee, and the transfers of assets from the old banks to the new banks, under the Icelandic emergency law, Act No 125/2008 on the Authority of Treasury Disbursements due to Unusual Financial Market Circumstances. By comparison, recognition has been sought for the moratoria which have now been ordered in respect of the three Icelandic banks under the Icelandic bankruptcy legislation relating to financial institutions, Act No 161/2002 on Financial Undertakings. Act No 125/2008 clearly bears a number of resemblances to the UK Banking (Special Provisions) Act 2008 and the Banking Bill.

primary purpose is not to realise the assets of the residual bank or to preserve or restore the financial situation of the residual bank but rather the procedure is there to support the commercial purchaser or bridge bank to which the assets and liabilities of the residual bank have been transferred[2].

8. If the bank insolvency and bank administration procedures do not fall within the relevant definitions of insolvency proceedings (or related terms) in the Winding Up Directive and the Model Law, such proceedings will not be automatically recognised throughout the EEA under the Winding Up Directive, and a foreign court in a jurisdiction which has implemented the Model Law will not be obliged to recognise the proceedings. Instead it will be a matter for the discretion of the courts of the EEA Member States or other jurisdiction where recognition is sought as to whether such proceedings are recognised. As has been demonstrated by some of the cross-border issues that have arisen in relation to the three Icelandic banks, this could lead to difficult conflict issues, particularly as the bank in question could well have branches and assets in a number of different jurisdictions.

9. We note that clauses 126 and 162 of the Banking Bill make it clear that any provisions in relation to bank insolvency and bank administration are to be treated as "insolvency law" for the purposes of section 426 of the Insolvency Act 1986. It is clearly possible to amend a domestic statute in this way but as the Winding Up Directive and the Model Law comprise EEA and international legislation, it is not possible to resolve this issue through UK legislation.

Principal concerns regarding Part 2 of the Banking Bill

Terminology and references to bank insolvency – clause 87

10. We believe that the reference to "bank insolvency" in clause 87 of the Banking Bill is confusing. While not defined in the Insolvency Act 1986, "insolvency" is usually an expression reserved for a state of affairs (i.e. cash flow insolvency or balance sheet insolvency) rather than a particular form of insolvency proceeding. The procedure described in Part 2 of the Banking Bill is clearly a modified form of liquidation procedure (as is reflected by the fact that the insolvency officeholder is referred to as

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2 By analogy, both Icelandic counsel and the Icelandic Financial Services Authority have confirmed that the appointment of the receivership committee, and the transfer of assets from the old banks to the new banks, under the Icelandic emergency law, Act No 125/2008 on the Authority of Treasury Disbursements due to Unusual Financial Market Circumstances would not be a winding-up proceeding or reorganisation measure falling within the scope of the Winding Up Directive (although the granting of a moratorium under the Icelandic bankruptcy legislation relating to financial institutions, Act No 161/2002 on Financial Undertakings, would be a reorganisation measure for these purposes). Act No 125/2008 clearly bears a number of resemblances to the UK Banking (Special Provisions) Act 2008 and the Banking Bill.

a "bank liquidator" and a "liquidation committee" is appointed). To maintain consistency of terminology within Part 2 of the Banking Bill itself, and with the insolvency proceeding under the Insolvency Act 1986 on which this procedure is modelled, we would suggest that the new procedure in Part 2 of the Banking Bill be referred to as "special bank liquidation", rather than bank insolvency. This may also assist with any arguments that the procedure is a winding-up proceeding for the purposes of the Winding Up Directive or a foreign proceeding for the purposes of the Model Law. In order to avoid confusion, for the purposes of this letter, we have continued to refer to bank insolvency.

Grounds on which the court may order a bank insolvency – clauses 90(4) and 93(1)(a)

11. A bank insolvency order can be made when a bank is unable, or likely to become unable, to pay its debts (clause 93(1)(a)). By clause 90(4), this definition is satisfied (inter alia) if the bank is in default of an obligation to pay a sum due and payable under an agreement the making or performance of which constitutes or is part of a regulated activity carried on by the bank. There is no grace period set out in relation to how long the payment default must have been outstanding and no *de minimis* requirement in relation to the amount that must be due. We are aware that similar wording is used in section 367(4) of the Financial Services and Markets Act 2000 regarding the FSA's power to petition for a winding up of an authorised person. Although section 367(4) does not lead to problems in practice, this is clearly in the context of an ordinary liquidation where creditors are dealt with on a *pari passu* basis and we have greater concerns where a potentially "light-touch" trigger could be used to commence a special procedure which favours one particular class of creditors (i.e. eligible depositors) above others (see below). It is clearly of some comfort that only the Bank of England, the FSA and the Secretary of State (and not an ordinary creditor) can apply for a bank insolvency order as it is assumed that such Authorities would act reasonably and would not rely on a minor payment default as a ground for applying for bank insolvency. As a practical issue, however, lawyers issuing legal opinions need to refer to the law rather than the assumed reasonableness of the particular Authority taking the decision. Accordingly, clients may not be able to get the level of comfort required for them to feel comfortable entering into a particular transaction.

Objectives of the bank liquidator – clause 96

12. In our view, this is the key provision of Part 2 of the Bill and we have three main concerns in respect of the current drafting:

    (a) we do not think that clause 96(2)(a) is sufficiently clear for the reasons given below;

    (b) if the intention behind clause 96(2)(a) is that the bank liquidator must transfer, together with the relevant deposit accounts, such assets as are necessary to persuade another financial institution to assume the liabilities in respect of the deposit accounts, this would have the effect (in practice) of preferring one particular class of creditors (i.e. the eligible depositors). While it is a question of policy as to whether eligible depositors should be given such preference, we consider that the aim of the legislation should be clear in this regard; and

    (c) it is unclear how a bank liquidator can begin working towards both Objectives 1 and 2 immediately upon appointment when, in practice, the Objectives are likely to be irreconcilable for the reasons given below. We have therefore suggested, in Schedule 3, two alternative forms of wording for the prioritising of the objectives based on the objectives of an administration in Schedule B1 to the Insolvency Act 1986 or the special purpose of a PPP administration in section 220 of the Greater London Authority Act 1999.

13. Our initial concern is regarding the meaning of clause 96(2)(a). As the relevant accounts referred to in that clause will be liabilities (rather than assets) of the insolvent bank, it is unlikely that another financial institution would take these on without either acquiring assets of equal value or receiving a payment equal to the value of the deposits (perhaps in each case with a deduction to reflect any goodwill associated with the deposits – see below). It is unclear, however, whether the liquidator is required, in the pursuit of Objective 1(a), to transfer sufficient assets from the insolvent bank to enable the other financial institution to take on the deposits or whether it is expected that a third party (such as the FSCS or the Treasury) would make the necessary payments to enable the other financial institution to take on the deposits[3]. It clearly makes a significant difference to the other creditors of the insolvent bank as to whether the transfer of the deposit accounts to another financial

[3] The FSCS clearly has this power pursuant to clause 120 of the Banking Bill but as this is expressed in permissive, rather than obligatory, terms, it is not clear whether it is expected that the FSCS will always make such payments.

institution is to be funded out of the assets of the insolvent bank (in which case those other creditors will be in a significantly worse position than if Objective 1(b) is pursued) or by third party funds and so we consider that the intention in this regard should be clearly spelt out in clause 96.

14. We note that, in clause 120 of the Banking Bill, the FSCS is given the power to make money available to facilitate the transfer of accounts of eligible depositors of the bank (although this is a permissive power rather than an obligation). We also note that, in the three transfer orders that were made under the Banking (Special Provisions) Act 2008 in respect of Bradford & Bingley, Kaupthing Singer & Friedlander Limited and Heritable Bank plc, the FSCS made a payment to the relevant purchaser[4] equal to the aggregate protected level of the deposits and the Treasury made a balancing payment up to the aggregate amount of the liabilities transferred[5]. In each case, the transfer order provided that the relevant transferor was liable to the FSCS in respect of the amounts paid by the FSCS and the Treasury, with an obligation on the part of the FSCS to account for any relevant receipts in respect of such claim to the Treasury. The FSCS's claim in this regard would be an ordinary unsecured claim and so would have no special priority. If the intention is that the FSCS and/or the Treasury will always fund the transfer of the relevant accounts to another financial institution in circumstances where the bank liquidator follows Objective 1(a), this will not have the effect of preferring the eligible depositors over the other creditors of the insolvent bank and we can see why, pursuant to clause 99(1), a liquidation committee comprising the Bank of England, the FSA and the FSCS (although query why not also the Treasury) would want to take the decision as to whether the liquidator should pursue Objectives 1(a) or (b). We consider that this intention should, however, be clearly set out in Part 2 of the Banking Bill.

15. The alternative interpretation of Objective 1(a) is that the liquidator is required to transfer sufficient assets of the insolvent bank to the other financial institution as are required to persuade the other financial institution to accept the transfer of the deposit accounts. Although the eligible depositors would be likely to be paid in full by the transferee, the transfer of matching assets would have the effect of depleting the assets of the insolvent bank and would therefore reduce the dividend payable to other creditors. This would therefore prefer the eligible depositors over other creditors of

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4 i.e. Abbey in the case of Bradford & Bingley and ING in the case of Kaupthing Singer & Friedlander Limited and Heritable Bank plc.

5 An amount of £612m in the case of Bradford & Bingley and £5m in the case of Kaupthing Singer & Friedlander Limited was deducted from the amount payable by the Treasury; we understand that the deducted amounts were intended to represent the goodwill associated with the deposits, such sums being payable to Bradford & Bingley and Kaupthing Singer & Friedlander Limited respectively.

the insolvent bank, not just in relation to the protected amount of their deposit but in relation to the entire amount of the deposit account (as clause 96(2)(a) refers to the relevant account and not the protected amount of such account). It is clearly a question of policy as to whether eligible depositors should be given such priority status in the event of a bank insolvency but, if this is the intention, we consider that the legislation should be clear in this respect. As currently drafted, the bank liquidator is not given an express power to transfer matching assets or to make any necessary payments to the transferee but would need to rely on his general powers under the applied provisions of the Insolvency Act 1986 to make the necessary transfers or payments. We consider that such powers should be clearly set out in Part 2 of the Banking Bill, together with any limitations on such powers.

16. Finally, in relation to clause 96, we do not see how a bank liquidator can begin working towards both Objectives 1 and 2 immediately upon appointment when, in practice, the Objectives may lead to very different considerations being taken into account. By way of example, if there is no limitation on Objective 1(b), the bank liquidator may consider that he needs to use the resources of his whole team to assist the FSCS in making the relevant payments (thus preventing that team from dealing with other creditor issues). The bank liquidator may also consider that he needs to keep the branches of the insolvent bank open so that payments can be made through such branches whereas it may be in the interests of the creditors as a whole to close down some or all of those branches, thus reducing the overheads and maximising the assets of the insolvent bank.

17. We note that the approach taken in clause 96 is very different from that taken in paragraph 3 of Schedule B1 to the Insolvency Act 1986 (regarding the priority of the objectives of an administration) and in relation to the purpose of the special administration regimes in respect of utility, PPP and railway companies (for example, as set out in section 220 of the Greater London Authority Act 1999). In the case of both the ordinary administration objectives and the purpose of the special administration regimes, there is a balancing of the higher objective or purpose with the interests of creditors generally. Hence in paragraph 3(3) of Schedule B1 to the Insolvency Act 1986, the administrator must only perform his functions with the objective of rescuing the company if that objective would achieve a better result for the company's creditors as a whole. Under section 220 of the Greater London Authority Act 1999, the administrator must manage the affairs, business and property of the company for the achievement of the special purpose of the administration order

(i.e. the transfer of the undertaking to ensure that the relevant activities are continued) *and* in a manner which protects the interests of the creditors of the company. We consider that either of these models would provide a more appropriate basis for balancing the objectives in clause 96 and we have suggested some alternative wording in this respect in Schedule 3 to this note.

18. Ultimately the issues we have addressed in relation to this provision all go to the clarity and interpretation of the clause. It is important that there is sufficient clarity to facilitate those objectives which the liquidator is expected to achieve under this clause.

Liquidation committee – clause 97

19. As you will be aware from our Responses we consider that there ought to be a representative creditor (other than an eligible depositor) on the liquidation committee from the outset. We suspect that it has been proposed that the liquidation committee initially consist of representatives of the Bank of England, the FSA and the FSCS because of the short time frame in which the liquidator is expected to achieve Objective 1 (which clearly will not allow sufficient time to convene a meeting of the creditors to select any members for the committee). However, particularly in light of our concerns in relation to clause 96, our view is that it is important that the creditors are in some way represented on the committee.

20. In order to deal with this issue we would propose that one of the Authorities (perhaps the Bank of England) should appoint an independent licensed insolvency practitioner (i.e. an accountant from a different firm to that of the bank liquidator) to consider the interests of the creditors. This insolvency practitioner should count towards the quorum for the purposes of clause 98(2).

Principal concerns regarding Part 3 of the Banking Bill

Terminology and references to bank administration

21. For different reasons to those outlined in paragraph 10 above in relation to bank insolvency, we also feel that the terminology used in Part 3 of the Banking Bill could potentially be confusing. It is currently possible to have an administration of a bank under the Insolvency Act 1986 and therefore we feel a bank administration under the Banking Bill should be distinguished from the ordinary administration process. We would suggest that the procedure in Part 3 of the Banking Bill be referred to as

"special bank administration". This would also maintain consistency of terminology if our proposal in paragraph 10 above (i.e. that bank insolvency be referred to as special bank liquidation) is adopted.

Objectives of the administration – clause 134

22. For the reasons given in our Responses, we still consider that Objective 1 is unduly onerous for creditors who are left behind in the residual bank. Such creditors have already been prejudiced by not being transferred to the private sector purchaser or bridge bank. It is therefore a double hit for such creditors that any remaining assets and resources in the residual bank are to be used, first and foremost, to support the activities of the transferee. Although the compensation provisions in the draft Safeguards Order clearly go some way to addressing these concerns, we consider that there are still issues in relation to how such compensation is quantified. Therefore we consider that Objective 1 should be balanced with the rights and interests of the creditors of the residual bank.

23. For similar reasons to those given in paragraph 16 above, we also do not see how a bank administrator can begin working towards both objectives immediately upon appointment when, in practice, the achievement of those objectives may require very different considerations or the bank administrator to pursue very different strategies. For example, where a particular services contract is personal to the residual bank and cannot be assigned to the transferee, the bank administrator may be obliged to keep at least part of the residual bank operating in order to sub-contract those services to the transferee whereas, pursuant to Objective 2, it may be in the best interests of the creditors as a whole to close down the operations, realise the assets and make distributions.

24. Using the models provided by paragraph 3 of Schedule B1 to the Insolvency Act 1986 or section 220 of the Greater London Authority Act 1999, we have suggested in Schedule 3 two alternative approaches to balancing Objectives 1 and 2 in a manner which would be fairer to creditors as a whole.

Table of applied provisions

25. We note that Table 2 applies the provisions of sections 178, 213 and 214 of the Insolvency Act 1986 to the bank administration procedure. Under the Insolvency Act 1986, these provisions are not available in an ordinary administration but are only available in a liquidation. We would be grateful if you could clarify why it is

considered that such provisions will be appropriate in the context of a bank administration.

Exit routes – clause 151

26. We note that the heading to this clause references a "winding-up or a voluntary arrangement". However, there does not seem to be any power under the Banking Bill for the bank to exit the bank administration via a company voluntary liquidation (i.e. paragraph 83 of Schedule B1 to the Insolvency Act 1986 is not applied). We were not clear whether this omission was deliberate or merely an oversight. If deliberate, we should be grateful if you could explain the reasoning behind excluding this exit route as it is one which is commonly used in relation to an ordinary company.

The Insolvency Law Committee of the City of London Law Society

19 December 2008

SCHEDULE 1

[Response to January 2008 consultation]

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Response

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Banking Reform consultation responses

Banking Reform Team

HM Treasury

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By email to: banking.reform@hm-treasury.gov.uk

21 April 2008

Dear Sir / Madam

Response of the Insolvency Law Committee of the City of London Law Society to the consultation document dated January 2008 entitled Financial Stability and Depositor Protection: Strengthening the Framework (the Consultation Paper)

Introduction

1 The CLLS responds to Government consultations on issues of importance to its members. The CLLS Insolvency Law Committee, made up of solicitors who are expert in their field, have prepared the comments below in response to the proposals, aimed at strengthening the framework for financial stability and depositor protection, contained in the Consultation Paper. In view of the expertise of the Committee (i.e. in matters relating to insolvency law), we have restricted our comments to the matters raised in part 4 of the Consultation Paper (reducing the impact of a failing bank). Members of the working party listed in Schedule 2 to this letter will be glad to amplify any comments if requested. We welcome the opportunity to comment on the consultation paper.

2 For the reasons given in this letter, we consider that the most significant concerns set out in the Consultation Paper (namely the issues of consumer confidence, the risk of a run on a bank experiencing financial difficulties and confidence in the financial system as a whole) can be addressed by focusing on the proposals set out in part 5 of the Consultation Paper in respect of the Financial Services Compensation Scheme (**FSCS**). We do not consider that a special resolution regime or a special insolvency procedure for a failing bank is necessary or desirable. In our view, provided that any concerns about the operation of the FSCS are separately addressed, the existing insolvency regime for English companies is and remains perfectly adequate to deal with an insolvent financial institution and there would be significant difficulties (in terms of commercial certainty, investor confidence and the impact on and interplay with the international arena in which financial institutions operate) in introducing new procedures.

3 In light of these views, we have not attempted to respond to all of the questions set out in chapter 4 of the consultation paper. Instead, we have set out our responses to those questions which are relevant in the context of our overall approach in Schedule 1 to this letter. The expression "Authorities" when used in this letter means the Bank of England, HM Treasury and the Financial Services Authority (**FSA**).

Consumer confidence and compensation arrangements

4 We consider that any concerns about consumer confidence and the risk of a run on a bank can be dealt with by reforms to the FSCS outside of any special resolution regime or special insolvency procedure. In our view, a depositor is not going to keep his or her money with a bank experiencing financial difficulties simply because he or she is aware of a special insolvency regime that may ultimately be used. Instead, the depositor will want to know that his or her money is safe and that, if the bank is not able to repay that deposit in a timely manner, there is a scheme in place to ensure that someone else does so.

5 We therefore consider that the focus of the Authorities should be on ensuring that the FSCS has the ability to make prompt payments to eligible depositors up to the agreed limit (whatever that may be chosen to be as a result of the present consultation). Having made any such payments, the FSCS could be automatically subrogated to the rights of the depositor against the bank rather than being required to take an assignment of the claim as is currently the case[6].

6 We appreciate that the ability of the FSCS to make timely payments will depend upon its having the necessary information to do so. We note the proposals in part 5 of the Consultation Paper in this regard including the potential introduction of new rules requiring banks to have readily available information on the account balances of FSCS-eligible depositors and the comment made in paragraph 5.25 of the Consultation Paper regarding the ability of the FSA to ask for relevant information through normal supervisory channels. Although we do not consider that our Committee is best placed to comment on the detail of these proposals, we consider that any improvements in the way in which the relevant information is provided to the FSCS would assist in the Authorities' objective of ensuring that the FSCS is in a position to make prompt

[6] See the FSA Handbook, COMP 7.2. It is not clear why the position is different for the FSCS in this regard when compared with the position in relation to the National Insurance Fund where there is an automatic subrogation of the employee's claim to the Secretary of State (see paragraph 12 below).

payments to eligible depositors if the bank becomes insolvent. We do not consider that this objective requires the introduction of a special resolution regime or insolvency procedure for banks.

7 Paragraph 5.22 of the Consultation Paper makes the point that, in cases where the bank's systems prove to be highly unreliable, it may not be possible for the FSCS to pay depositors within the timeframe contemplated by the Consultation Paper. We consider that it is ultimately the responsibility of the FSA to ensure that the bank's records are not deficient in this regard, possibly through having the ability to carry out "spot-checks" either prior to or following the FSA becoming aware that the bank is experiencing financial difficulties. If the principal objective is to protect depositors, we consider that the FSCS (and ultimately the Government and the Bank of England as its liquidity funders) should bear the risk of the bank's records being incorrect resulting in the FSCS being unable to recover from the bank (through its subrogated rights) any payments it has made to eligible depositors.

8 Paragraph 4.37 of the Consultation Paper proposes that the statutory objective of the special insolvency regime being proposed for banks should be for the insolvency practitioner to assist and co-operate with the FSCS to coordinate rapid payments to eligible depositors or to effect a transfer of accounts to a third party (the principal objective) with the duties to the creditors as a whole being subordinate to this principle objective. In practice, an insolvency practitioner is likely to assist the FSCS in any event as it will be in the interests of one set of creditors (i.e. depositors) for him or her to do so. If it were considered necessary to legislate for such a duty (which we do not consider to be the case), this could be done by adding a duty to assist and co-operate with the FSCS to the existing insolvency legislation; it does not require the introduction of a special insolvency regime. Furthermore, even though we accept the importance of protecting depositors for the reasons given in the Consultation Paper, we do not consider that any duty to assist the FSCS should be at the expense of the insolvency practitioner's duties to the creditors as a whole. Where such creditors include employees or pension funds, there are equally valid public policy reasons for protecting their rights.

9 We understand that concerns have been raised in relation to the resources of the FSCS and its ability to cope with the large number of claims that it may need to process if a major financial institution were to become insolvent. Ultimately the resourcing of the FSCS is a matter for the Authorities but in our view, there must be other solutions to this issue than introducing a new principal objective in a special insolvency procedure requiring the insolvency practitioner (or the bank's employees) to assist with handling claims. We note that, when the Pensions Regulator and the PPF were established, people were seconded from banks, accountancy firms, law firms and other institutions

to deal with the large volume of work that it was anticipated would be generated by the new legislation. We wonder whether there may be a precedent here (together with secondments from the FSA)?

10 We also note that the Authorities are considering whether the FSCS should make payments on a gross, rather than a net, basis to facilitate quicker payments to depositors. It has been suggested by the Authorities that, if this approach were to be taken, it might be necessary to make changes to the insolvency set-off rules. This could clearly have a significant impact on the financial markets generally and close-out netting in particular. As the Consultation Paper did not go into any detail regarding the proposed changes to the insolvency set-off rules, we have not considered this issue in this paper but we would welcome the opportunity to meet with the Authorities to discuss the implications of any such changes. We have been offered such a meeting by Mr Lee Hewlett, currently with HM Treasury, and hope to meet with him in the next few weeks.

Reasons why special resolution / insolvency regime is neither necessary nor desirable

11 As referred to above, we do not consider that a special resolution regime or a special insolvency procedure for banks is necessary in order to deal with the stated concerns regarding consumer confidence and financial stability. Indeed, we consider that the legal uncertainties that would arise from such procedures (in respect of their potential impact on investor and creditor rights) could contribute to a lack of confidence in the system and greater financial instability as a consequence.

12 In relation to the FSCS, we consider that an analogy can be made with the National Insurance Fund out of which the Secretary of State for Trade & Industry makes payments to the employees of insolvent employers under section 182 of the Employment Rights Act 1996. Upon the making of the payment, any rights and remedies of the employee in respect of his or her debt automatically become rights and remedies of the Secretary of State (section 189(1) of the Employment Rights Act 1996) The Secretary of State also has the right to require information from the employer for the purposes of making the payment to the employee (section 190). These provisions do not require a special insolvency regime nor any amendments to the objectives of the insolvency proceedings or the duties of the insolvency practitioner to ensure that the public policy objective is met of ensuring that employee claims are dealt with in a timely manner.

13 We consider that the existing English insolvency procedures (especially schemes of arrangement, company voluntary arrangements and administrations) are very flexible and have proved perfectly adequate for dealing with complex companies with multiple stakeholder groups. We cannot see why a financial institution should be any different or should merit a special procedure, especially once concerns about customer deposits

are dealt with through a review of the FSCS. We are concerned that a proliferation of special or modified insolvency regimes could lead to what is sometimes referred to as "carve-out complexity". There are now at least 22 different insolvency processes (or modified insolvency processes) for corporates, regulated entities, partnerships and non-corporate entities. This proves confusing even to an English practitioner; the regimes are even harder to justify and explain overseas. In our view, this jurisdiction should be setting an example to others in having a clear, comprehensible insolvency framework. A multiplicity of insolvency proceedings (especially where these are not necessary) simply leads to a lack of legal and commercial certainty as to the regime that will apply in a particular case.

14 Clearly there are cases where a special insolvency regime has been introduced such as for protected railway companies (as was used in the case of Railtrack) and for PPP companies (as is currently being used in the case of Metronet). In each case, these special procedures are intended to protect a public service or utility (such as the rail or tube network) where the consumer may have little choice as to the alternatives. This is not the case with a financial institution where a customer is free to move his or her monies to another bank or to choose another bank to perform the relevant services. Furthermore (perhaps unusually for the size of company involved) the operations of the regulated companies that are currently subject to special insolvency regimes (such as protected railway companies, PPP companies, water and sewerage undertakings and air-traffic services companies) tend to be domestic to the UK. This means that it is not so important to consider the cross-border implications of having special regimes in relation to such companies. A financial institution of any significant size, on the other hand, is much more likely to have cross-border dealings. We have considered in the next paragraph why the introduction of a special resolution regime or special insolvency procedure could have undesirable consequences in an international arena.

15 Unless the introduction of a special insolvency procedure is looked at in the context of the wealth of recent legislation with a cross-border aspect, there is a risk that any change to the regime in the UK could have unintended consequences outside this jurisdiction. For example, the proposals would need to be considered in the light of Directive 2001/24/EC on the reorganisation and winding up of credit institutions, The Credit Institutions (Reorganisations and Winding up) Regulations 2004, Directive 2002/47/EC on financial collateral arrangements, The Financial Collateral Arrangements (No 2) Regulations 2003 and the legislation in other jurisdictions implementing the UNCITRAL Model Law on Insolvency Proceedings (to the extent that such legislation is applicable to credit institutions). This legislation is not considered in any detail in the Consultation Paper. To give an example of the types of question that might arise, it is unclear whether the special resolution regime or the special insolvency procedure (which both appear to be largely regulatory driven) would fall within the

definition of winding up proceedings or reorganisation proceedings in Directive 2001/24/EC so as to achieve recognition across the EEA. Furthermore, consideration should be given to the impact of the commencement of a special procedure on the rules of international clearing systems or events of default under netting and other agreements. Although it may be possible to legislate in this jurisdiction for a suspension of such events of default, there is no guarantee that such legislation would be effective in other jurisdictions.

16 We are also concerned that the introduction of new regimes which could adversely affect the rights of creditors and investors will create an unlevel playing field across the EEA. This may result in an overseas bank choosing to establish an authorised subsidiary in, say, Germany (in order to make use the EEA passporting provisions for accepting customer deposits) rather than in the UK in order to avoid the special resolution regime. Any measure which may have the affect of driving companies away from the UK is surely undesirable to the economy as a whole.

17 Finally, we note that comparisons have been drawn throughout the consultation process to the regime that applies to banks in the US under the Federal Deposit Insurance Act. It should be noted, however, that this regime has largely been used in relation to small, domestic banks and there are real doubts as to how the regime would fare if a major bank with substantial non-deposit liabilities, complex non-traditional on and off-balance sheet activities and international operations (including potentially an overseas holding company) were to become insolvent[7].

The Insolvency Law Committee of the City of London Law Society

21 April 2008

[7] See for example Robert Bliss and George Kaufman, US Corporate and Bank Insolvency Regimes: an Economic Comparison and Evaluation, 10 January 2006, WP 2006-01.

Schedule 1

Response to specific questions in part 4 of Consultation Paper

Question	**Response**
4.1	For the reasons given in the main body of this letter, we consider that it is unnecessary and positively undesirable to have a special resolution regime for banks. We can see no reason why the concerns set out in the Consultation Paper could not be addressed through changes to the FSCS or minor amendments to the existing insolvency proceedings. For this reason, we do not intend to respond to questions 4.2 – 4.4.
4.5 – 4.6	We do not consider that the potential abridgement of property rights in the special resolution regime can be justified as the public interest can be met by other means (i.e. changes to the FSCS). We are concerned that any such abridgement could result in the lack of commercial and legal certainty for creditors of and investors in banks and that this could ultimately result in the investment in banks being reduced.
4.7	A procedure already exists under Part VII of the Financial Services and Markets Act 2000 in relation to the transfer of a bank's business (including its deposit-taking business). If the Authorities are concerned about the publicity surrounding an application for such a transfer scheme, views could be taken as to whether it might be appropriate (in extreme cases) to allow applications under Part VII to be heard *ex parte* provided that creditor rights are not affected. We consider that it is essential in terms of the fairness and transparency of the regime that any creditor whose rights are adversely affected is entitled to be heard by the court in relation to the proposed transfer.

	Furthermore, if the directed transfer is intended to facilitate a sale to a third party purchaser, we understand that one of the issues that arose in relation to Northern Rock was that the Bank of England was unable to fund one of the potential bidders due to State aid issues. There is not sufficient detail in relation to the proposed special resolution regime for us to be able to comment on any State aid issues arising from a directed transfer *per se* but if and to the extent that a purchaser requires funding from the Bank of England, we cannot see how the proposals would address these issues.
4.8 – 4.9	We consider that the Companies Court is the best place for any disputes in relation to a transfer scheme to be heard. This court has extensive experience in dealing with the types of issue that are likely to arise. If the Financial Services Tribunal were chosen as the appropriate forum, there may be a conflict of interests (or perceived conflict) in view of the responsibilities of the FSCS.
4.10	For the reasons given in the main body of this letter, we also consider that it is unnecessary and positively undesirable for the Authorities to be able to take control of a failing bank through effecting a transfer of some or all of its assets and liabilities to a bridge bank.
4.11 – 4.13	See our response to 4.7 – 4.9 above.
4.14	For the reasons given in the main body of this letter, we also consider that it is unnecessary and positively undesirable for a new bank insolvency procedure to be introduced for banks and building societies. The existing procedures are perfectly adequate for dealing with such institutions and the potential impact of private law rights and commercial certainty could have a detrimental impact on financial stability. In the circumstances, we have not

	responded to questions 4.16 – 4.19.
4.15	An administrator already has extensive powers to continue trading all or any part of the business in the interests of creditors.
4.20	If the proposed changes are made to the FSCS, we do not consider that it would be necessary to introduce the concept of depositor preference and serious thought would need to be given to a bank's on and off-balance sheet activities (including for example any securitisations) if this concept were to be introduced. We note, however, that if a decision is taken to introduce such a concept, this can be done without the need for a special insolvency regime. In the case of insurance companies, policyholders were given preference by virtue of the Insurers (Reorganisation and Winding Up) Regulations 2003 without wholesale changes being necessary to the insolvency legislation relating to insurance companies.
4.21	We are very concerned about the idea of a 14 day moratorium in which the directors would not be able to commence insolvency proceedings and creditors would not be able to enforce any security (even though, presumably, depositors would be entitled to withdraw their deposits, notwithstanding that security over those deposits may have been granted to third parties). In our view, there would be a significant risk of a run on the bank during the 14 day notice period, particularly in view of the uncertainty as to the final outcome. Such proposals may also discourage anyone from taking an appointment as a director of a bank as there is no suggestion that the fiduciary duties, or potential wrongful trading liabilities, of a director would be suspended during this period, even though the director would be powerless to take any steps to protect creditors by commencing an insolvency process.

4.22 – 4.24	In our view, the proposed role of the restructuring officer sits uncomfortably between that of a director and that of an insolvency officeholder. Although the Consultation Paper appears to envisage that the appointment would be part of the special resolution regime (and therefore a pre-insolvency step), the suspension of the management powers of the directors in favour of those of the restructuring officer is more akin to the commencement of a formal insolvency process. We consider that the role of an administrator or liquidator (and the duties owed by such a person) are clearly understood whereas there is the potential for confusion to arise over the role and duties of such a restructuring officer. As referred to in our response to question 4.21, it would also be necessary to address the potential liabilities of the (now powerless) directors during the period in which the restructuring officer was appointed. Finally, careful consideration would need to be given to the impact of such an appointment on events of default and other triggers in netting agreements, clearing house rules and other arrangements (particularly those with an international dimension) in view of the overlap between the role of the restructuring officer and that of an insolvency practitioner.
4.25	We do not consider that the nationalisation of a bank would, in every case, be a more orderly resolution than (for example) a sale through an administration. In any event, as the Government has the power to pass emergency legislation in this regard on a case by case basis (as has been demonstrated recently in respect of Northern Rock), we do not see why a general power is needed. We are also unclear what such a power is seeking to achieve in terms of increasing customer confidence.
4.26 – 4.30	Special issues arise in relation to building societies (where the depositors are also members of the society), especially in relation to any transfer of the assets to a corporate entity. Until there is more clarity in relation to the

	regime that is being proposed, we do not consider that we are in a position to comment in any detail on this series of questions.
4.31 – 4.34	As we do not support the proposals for a special resolution regime, we have not considered where the costs of such a regime should fall.
4.35 – 4.36	It is not clear to us from the Consultation Paper what financial collateral arrangements are being contemplated in this respect and, without more detail, we do not consider that we are in a position to comment.

Schedule 2

Members of Working Group

Hamish Anderson, Norton Rose LLP

Maureen Farrell, Herbert Smith LLP

Stephen Gale, Herbert Smith LLP

Ian Hodgson, Slaughter and May

Jennifer Marshall, Allen & Overy LLP

[*Response to July 2008 consultation*]

It should be noted that, since this submission was submitted, the Banking Bill has been published and the areas of greatest concern are now to be dealt with by statutory instrument, which it is hoped will enable these concerns to be effectively addressed.

The City of London Law Society

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Response to consultation document dated July 2008 entitled "Financial Stability and Depositor Protection: Special Resolution Regime"

The City of London Law Society (**CLLS**) represents over 13,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to Government consultations on issues of importance to its members. The CLLS Insolvency Law Committee, made up of solicitors who are expert in their field, have prepared the comments below in response to the proposals regarding the implementation of a special resolution regime (the SRR) for a failing UK bank or building society contained in the **consultation document dated July 2008 entitled "Financial Stability and Depositor Protection: Special Resolution Regime"**.

By email to: banking.reform@hm-treasury.gov.uk

Banking Reform consultation responses
Banking Reform Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

17 September 2008

Dear Sir / Madam

Response of the Insolvency Law Committee of the City of London Law Society to the consultation document dated July 2008 entitled Financial Stability and Depositor Protection: Special Resolution Regime (the SRR Consultation Paper)

Introduction

1 The City of London Law Society (**CLLS**) represents over 13,000 City lawyers, through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

2 The CLLS responds to Government consultations on issues of importance to its members. The CLLS Insolvency Law Committee, made up of solicitors who are expert in their field, have prepared the comments below in response to the proposals regarding the implementation of a special resolution regime (the **SRR**) for a failing UK bank or building society[8] contained in the SRR Consultation Paper. Members of the working party listed in Schedule 2 to this letter will be glad to amplify any comments if requested.

3 We refer you to our response (the **First Response**) to the January consultation paper entitled Financial Stability and Depositor Protection: Strengthening the Framework (the **January Consultation Paper**); a copy of our First Response has been published on the HM Treasury website[9]. In our First Response, we queried the need for a special resolution regime or special insolvency procedure to deal with a failing bank in light of

[8] We have referred elsewhere in this letter to a failing bank but similar concerns apply in relation to a failing building society subject to the special issues discussed below in response to questions 5.1 to 5.9 of the SRR Consultation Paper.

[9] ILC-CLLS Insolvency Law Committee of the City of London Law Society.

the proposed changes to the Financial Services Compensation Scheme (the **FSCS**) which, in our view, would achieve many of the expressed objectives of protecting depositors and enhancing public confidence. We also expressed serious concerns regarding the impact that such special procedures could have on legal certainty, investor confidence and the international arena. We note that our comments (and the comments of many other respondents to the January Consultation Paper) appear not to have been taken into account in the further consultations. The concerns we expressed in our First Response still stand and this letter should be read in conjunction with them.

4 We believe that there is still an important debate to be had as to the balance to be struck between the protection of depositors and the existence of wide-ranging powers and flexible procedures to avoid the insolvency, and to rescue the "good" business, of a failing bank on the one hand and the erosion of the rights of stakeholders (with potential implications for the cost of lending, UK competitiveness and ultimately financial stability) on the other. In light of this, we do not believe that it is sensible or valuable at this stage to comment on the drafting of the proposed legislation. Instead we have set out below our main concerns arising from the SRR Consultation Paper followed by (in Schedule 1) our detailed responses to those questions which are relevant in the context of our overall approach.

5 We also remain of the view that the timetable proposed in the SRR Consultation Paper is too ambitious for a debate of this magnitude and we would strongly encourage the Banking Reform Team to extend the period for resolving some of the difficult issues that arise. There is a danger here that the Government will "legislate in haste and repent at leisure". Although we are aware that the provisions of the Banking (Special Provisions) Act 2008 expire in February 2009 and that this is (in part) what is driving the proposed timetable, it would always be open to Government to extend the duration of this temporary legislation in order to consult properly on the issues that arise.

6 The expression "Authorities" when used in this letter means the Bank of England, HM Treasury and the Financial Services Authority (**FSA**).

Principal concerns regarding the SRR

7 Any debate concerning the SRR should involve a balancing exercise between the advantages (to the UK financial system and stakeholders including depositors) of giving the Authorities flexible and wide-ranging powers to avoid an insolvency, and to rescue the profitable parts of the business, of a failing bank on the one hand and the impact that such powers will have on legal certainty, stakeholder rights and ultimately investor confidence on the other. In our view, the focus to date has been too much on the former and insufficient thought has been given to the consequences of the SRR on the latter.

Impact on legal certainty

8 Legal certainty and transparency is essential in a distressed situation. Counterparties dealing with a UK bank experiencing financial difficulties will want clear advice about their rights, powers and remedies in an insolvency or pre-insolvency scenario (including the impact of any special regime on contractual rights, security interests, rights of set-off and ranking in any insolvency process). Such advice will not only inform the decision as to whether that counterparty chooses to deal with the UK bank in the first place (rather than, say, a German bank) but will also affect the pricing of the particular transaction in question. The legal advice given to rating agencies regarding the impact of a UK bank insolvency on, for example, a securitisation or structured finance transaction may well affect the rating of that transaction (and hence the price at which the UK bank can raise funds through such transaction) and the legal advice given to the FSA in respect of netting or security arrangements can affect the amount of regulatory capital that a UK bank is required to carry.

9 Our principal concern regarding the proposals for the SRR is that it will be extremely difficult to give counterparties clear and definitive advice regarding their rights, powers and remedies in such a scenario. This is in large part because of the proposals regarding partial transfers (discussed further below); a counterparty will have no way of knowing in advance whether its liabilities will be transferred across to the bridge bank or private sector company or whether it will be left behind with the underperforming assets. Further uncertainty arises from the fact that it is proposed that: (a) any safeguards for stakeholders be contained in a Code of Practice (the legal status of which is uncertain and the details of which we have not yet seen); and (b) the Treasury should have the power by secondary legislation to make further provision as to the nature and effect of the property transfer powers (paragraph 3.11 of the SRR Consultation Paper).

10 Ultimately any uncertainty as to how the SRR will operate in practice and a lack of appropriate safeguards in respect of stakeholder rights could contribute to (rather than prevent) financial instability if it resulted in a loss of investor confidence in the UK banking system. Any legal uncertainty in this area could cause other banks to choose to invest elsewhere (rather than choosing to support a UK bank experiencing financial difficulties) or may, at the very least, raise the costs of funding for UK banks. If an investor discovers or anticipates that the rules of the game have changed or may change and that it may not form part of the orderly queue of creditors in an insolvency process (or that fewer assets might be left for creditors than would otherwise have been the case), that investor is likely to demand a larger risk premium. Increased risk premia mean increased credit spreads and any measure that widens credit spreads on UK banks at this time would be unwelcome.

11 In our view, there is a risk that the SRR (as proposed) could result in a loss of competitive advantage for the UK banking system (within the EEA in particular) by encouraging investors to invest in non-UK banks rather than UK banks, or by encouraging non-EEA banks to establish EEA banking subsidiaries outside the UK, because of concerns regarding the lack of legal certainty of the proposed UK regime as highlighted above.

Objectives of the SRR

12 Throughout the consultation process, the emphasis of the Authorities has been on preventing systemic failure and protecting depositors. For the reasons given in our First Response, we consider that the second of these two objectives can be addressed through improvements to the FSCS. In relation to the first objective, we consider that any proposals which might ultimately discourage counterparties from dealing with a UK bank that is experiencing financial difficulties (because of a lack of legal certainty as to such counterparties' rights in an insolvency scenario) could be detrimental to the rescue of that bank and could thus (potentially) increase the chance of systemic failure. We do not consider that sufficient emphasis has been given, in the consultation process, to investor confidence and inter-bank lending through the wholesale market.

Partial transfers

13 We consider that partial transfers (either to a private sector purchaser or a State-owned bridge bank) and the corresponding impact on contractual rights, security interests, rights in an insolvency and (in practice) the ranking in an insolvency process are the most problematic aspect of the SRR Consultation Paper and we would strongly suggest that such proposals are not taken forward by the Authorities. While we acknowledge that partial transfer undoubtedly increases the chances of a successful operation and sale of a bridge bank and/or private sector purchase, the real question is one of the cost-benefit analysis – whether the ongoing costs to the industry in allowing partial transfer (in particular in the commercial ramifications for legal and contractual certainty) outweigh the benefits. We believe that the costs substantially outweigh the benefits. We are therefore of the view that the partial transfer power is so fundamentally inimical to the certainty which the markets require to operate efficiently as to be unjustifiable and counterproductive.

International context and state aid issues

14 The proposals need to be considered in an international context. It is not clear whether partial transfers or provisions nullifying or varying contractual rights would be recognised outside the UK or in respect of contracts governed by laws other than English law. It is also not clear whether the special administration regime or the

modified liquidation regime referred to below would be recognised as "insolvency procedures" for the purposes of the Credit Institutions Winding-Up Directive so as to be recognised throughout the EEA. We suspect the modified liquidation procedure would be recognised but it is less clear that this would be the case in relation to the special administration regime for dealing with a residual company following a partial transfer to a bridge bank.

15 The potential state aid issues that arise in relation to partial transfers to bridge banks, public funding and the payment of fees by a bridge bank for the provision of services by the residual company through the special bank administration procedure have not been fully considered in the consultation papers.

16 Finally, we note that the proposed SRR seems to be heavily based on, and influenced by, the US model and the tools the Federal Deposit Insurance Corporation has at its disposal. The expertise of the working group does not extend to US law and we are not therefore able to comment on the relative merits or success of the US model. However, we would question whether the Federal Deposit Insurance Act (**FDIA**) is a good precedent for the UK given that: (a) it was created for small, local, deposit-taking banks and not the large, global, financially complex institutions we have in the UK; and (b) the European banking sector is markedly different to that in the US (where the banks' activities are limited by US law to engaging in specified activities such as deposit-taking, lending, custody and trust activities). We would also note that the FDIA has yet to be tested in a large-scale bank insolvency. It is not clear how successfully it would operate in the context of the failure of a systemically important bank.

The Insolvency Law Committee of the City of London Law Society

September 2008

Schedule 1 to the response of the CLLS Insolvency Law Committee

Responses to Specific Questions in the Second Consultation Paper

Question	Response
SRR objectives, roles and governance	
2.1	We agree with the first objective namely protecting and enhancing the stability of the financial systems of the UK. However, for the reasons given in the main body of our response, we believe that investor confidence and legal certainty regarding stakeholder rights are essential aspects of such stability and we are not convinced that these aspects are sufficiently protected by the SRR proposals. In relation to the second two objectives[10], we believe that the Authorities' focus on protecting depositors at the expense of, and potential detriment to, other stakeholders could cause long term damage not only to the stability of the UK financial markets but also to the attractiveness of those markets. If the aim of the legislation is to protect depositors, enhance consumer confidence and prevent a run on a bank then (in our view) this could be achieved by reforming the FSCS. Whilst we understand and appreciate the benefits associated with, and resulting from, the ability of the Authorities to exercise powers to rescue a bank pre-insolvency in terms of preventing the consequences of another Northern Rock, the Authorities must be careful that, in exercising these powers, they do not undermine market and inter-bank confidence. If the SRR proposals ultimately discourage other banks from lending to a UK bank facing financial difficulties (because of any uncertainties as to the rights and position of such lending banks in the event of the SRR being utilised), this could seriously jeopardise the rescue of that failing bank and thus potentially lead to the financial instability that the SRR is intended to prevent. We consider that a new objective should be added, or the second objective should be amended, concerning investor and market confidence in the stability of the banking systems of the United Kingdom.

[10] In relation to objective 2, we note that the word "public" is not defined and could conceivably include wholesale investors as well as consumers. Similarly objective 3 could in theory include wholesale as well as retail depositors. However, in view of the emphasis on consumers and retail depositors elsewhere in the paper, we assume that these expressions are not intended to include commercial counterparties. This should clearly be clarified in the legislation.

	In relation to both objective 3 and objective 4, we are concerned that such objectives could give rise to an inference that depositors and public funds are to be preferred over other creditors despite the Authorities' proposal that such parties should not be given statutory priority in the modified liquidation process. If the inclusion of objectives 3 and 4 were to lead to a partial transfer being used to transfer deposits and public funding liabilities to the new entity, while leaving other creditors behind with the residual bank, this would result (in practice) in the depositors and the Authorities being in a better position than other creditors. We have no objections to objective 5 but it is unclear how this objective is to be reconciled with the others (and in particular 3 and 4).
2.2	Under the proposals, the FSA will be the gatekeeper to the SRR. The FSCS is under the auspices of, and is controlled by, the FSA. We would like to understand the Authorities' views on the proximity of this relationship. Any nexus between the two institutions necessarily raises questions regarding independence and autonomy. Do the proposals contained in the SRR Consultation Paper create potential grounds for conflict between the FSA and the FSCS in respect of their respective roles and duties in relation to the SRR? What safeguards will be put in place should conflicts arise? We consider that further details need to be provided in this regard.
2.3	In view of the expertise of the working group, we do not feel we are adequately experienced or qualified to comment on the suitability or adequacy of the proposed triggers to be used by the FSA in determining when (and if) to employ any of the SRR tools. However, we consider that any triggers must be clear, objective and transparent to all investors and market participants.
2.4 – 2.5	We have no comments regarding the proposed division of roles and duties between the Authorities as set out in the SRR Consultation Paper. We would, however, urge the Authorities to explore further the role the courts should play in reviewing not only the Authorities' decision-making process but also the implementation of any of the stabilisation tools so as to afford all stakeholders an extra level of comfort and protection. We believe that, given the inevitable interferences with contractual and property rights and any potential for contravention of the Human Rights Act which may result from implementation of

	any of the tools, it is imperative that all stakeholders should have recourse to the courts in order to be able to challenge the decisions of the Authorities. We note that, unlike the January Consultation Paper, the SRR Consultation Paper does not refer to a Chief Restructuring Officer (or person of similar stature and responsibility). We presume that this is a deliberate omission and that the Authorities have decided against the creation of such a role. Although we acknowledged in our First Response that there would be difficulties in defining the duties and responsibilities of such a person, the proposal that an experienced restructuring officer be appointed did give us some comfort that the SRR would be well-managed and would not be subject to the vagaries and whims of political spin-doctors. The SRR Consultation Paper proposes that the Bank of England would, in selecting which stabilisation tool to use, have regard to the "public interest". It is not clear what this expression is intended to mean (and we note that it is not defined in the draft legislation). Given the focus of the Authorities on protecting depositors, we are worried that "public interest" will be equated with depositor protection and that the stabilisation tool selected will be that which is most in the interests of depositors (rather than stakeholders generally). Maintaining investor and market confidence in the financial markets could also be said to be in the public interest and, in some instances, could be more important than protecting depositors who already have the benefit of the FSCS. As a related point, we query whether the protection of depositors should be, of itself, sufficient to trigger implementation of one of the stabilisation tools (draft clause 8(2)(c)). If depositor confidence and protection are addressed through the reform of the FSCS then surely the protection of depositors should not on its own be a reason for putting a failing bank into the SRR? Finally in this regard, we note that, as currently proposed, the Bank of England would dominate the discussion as to what stabilisation tool to implement and how such tool should be implemented (including, in the case of a partial transfer, the choice of the assets and liabilities to be transferred across or left behind). This puts a significant burden on the Bank of England which will undoubtedly face huge criticism and/or adverse publicity if (with the benefit of hindsight) the judgment calls exercised by it are called into question.

2.6 – 2.7	As a means of indicating how the Authorities will deal with the run-up to, and the implementation of, the SRR, we consider that a code of practice may have some value. However, for purposes of legal certainty (and in particular when providing safeguards around the property or contractual rights that can be disturbed by the operation of the SRR), non-binding guidance in relation to the exercise of powers by the Authorities is valueless (particularly in the absence of any precedent). These matters should, instead, be set out in the legislation itself. The legal status of the code of practice as proposed by the SRR Consultation Paper is uncertain. The Authorities seem to envisage that such a code will be given a statutory footing (paragraph 2.28). We agree with this approach and think that any code of practice must be enshrined in legislation. Given the potential importance of the code to counterparty confidence and legal certainty, we believe that it should be publicly consulted on before implementation; accordingly we would be grateful to be given the opportunity to review and comment on the draft legislation. Any amendments to and updating of the code should also be the subject of consultation. It is also essential that any code of practice is brought into force at the same time as the rest of the legislation regarding the SRR. In relation to the special railway administration regime that was introduced by the Railways Act 2003, the detailed rules concerning the procedure were not made available until after Railtrack plc (the first company to use the regime) had gone into railway administration. We are keen to ensure that such a situation is not repeated in the case of the SRR.
SRR tools: stabilisation powers and compensation	
3.1	For the reasons given above, we have not reviewed in detail draft clauses 14 to 23 and our views set out below on the property transfer powers are of a general nature. It is in the interests of legal certainty that a party to a contract or other legal

	instrument can take clear advice as to its rights and obligations. In principle, a transfer of all the business of a bank to a bridge bank or private sector purchaser could be thought to be relatively uncontroversial. However, the proposed property transfer powers go wider than the mere transfer of contractual and property rights: they also enable the Authorities to vary the rights of third parties. In particular, clause 19 of the proposed draft legislation empowers the Authorities to override termination or close-out rights under instruments which are transferred. The consultation and the draft legislation leave unanswered the question of whether termination rights which may arise by virtue of events related to the transfer, rather than by virtue of the transfer itself (such as the substitution of a new counterparty to the transaction or the exposures of the bank / transferee to the counterparty exceeding a certain limit) could also be overridden. This will be a question of key importance to counterparties whose rights are transferred as the loss of the right to close out or terminate on a property transfer (or certain related events) will be of commercial value to them. If left as they stand, the property transfer powers will give rise to qualified enforceability opinions. The SRR Consultation Paper (and the earlier July consultation paper) propose that the Authorities be able to vary, nullify or create contracts (a statutory override) in two other circumstances. These are where contractual or other provisions present a barrier to the Bank of England lending or taking action under the SRR (for example negative pledges), or where a bank which is in the SRR relies on members of its group for services (such as employees, systems, payroll provision etc). The possibility of a statutory creation, alteration or nullification of a contract negotiated on arms' length terms is an extremely worrying development from a legal standpoint. These proposals would effectively negate counterparty rights and/or subordinate the rights of market participants to those of the Authorities. We consider that this would be fundamentally prejudicial to counterparties and group members, give rise to legal uncertainty and raise the costs of funding for UK banks as a result. We also query how the property transfer powers are to be used where assets are located overseas. Although clause 20 purports to apply such powers to foreign property, it is not clear whether such powers would be recognised in a jurisdiction outside the UK in which property is located or whose law governs the contract in question. It is also unclear how clause 20(4) is intended to operate. As a matter of English law, is such property held on trust for the transferee (and if so should clause 20(4) not make this clear) and how does this work if the jurisdiction in

	which the property is located does not recognise a trust? We are particularly concerned regarding the proposal in paragraph 3.11 of the SRR Consultation Paper that the Treasury be able, by secondary legislation, to make further provision regarding the nature and effect of the property transfer powers. This would result in further legal uncertainty for counterparties and we do not see why all necessary provisions could not be included in the primary legislation.
3.2	We consider that the share transfer powers are generally acceptable (subject to appropriate compensation provisions for existing shareholders) and, in practice, we think that this is the most likely tool to be used to transfer the business of a failing bank. However, we consider that there should be further consultation on the proposed powers to modify the nature and terms of the securities being transferred as, again, this leads to legal uncertainty on the part of the investor. It is currently unclear as to when (and why) it is proposed that such a power would be used.
3.3	We agree that a company limited by shares is the most appropriate legal form for a bridge bank (although this may not be the case in relation to a transfer of the business of a building society for the reasons given below). It is not clear, however, how such a bank would be capitalised. Would such capital be provided by the Bank of England and, if so, what return on capital (if any) would the Bank of England anticipate and how would this: (i) rank relative to the interests of disenfranchised stakeholders in the failing bank; and (ii) interrelate with payment for the SRR by the FSCS? Would the bridge bank need to comply with the regulatory capital requirements applicable to banks at inception or would there be special rules for such a bank? More detail is needed on these points. It is also not clear who would be appointed as directors of the bridge bank. Paragraph 3.31 suggests that the directors may be selected by the Bank of England from amongst the existing directors of the failing bank (but excluding senior members of management who had contributed to the failure of the original bank) but there is clearly a question as to whether such directors would be willing to take on the corporate governance of the bridge bank. The SRR Consultation Paper does not specify whether the directors of the bridge bank would owe the usual fiduciary duties and be subject to the usual wrongful / fraudulent trading

	liabilities in the event of an insolvency of the bridge bank and further clarification is needed in this area. In particular, to whom would they owe their duty of care – the Authorities or the failing bank's creditors? There is a scope for conflict if the directors' roles and duties are not clearly defined. We would also welcome further clarification regarding what a bridge bank will be able to do in terms of banking functions. Is it envisaged that it will be able to accept new deposits or to accept new business? There is a real risk that allowing it to carry out traditional banking activities could distort the inter-bank market. There is an argument that, because of the bridge bank's healthy and attractive balance sheet and because it is in effect supported by the Authorities, there is the chance that it will have a competitive edge over other banks. Have the Authorities considered these concerns?
3.4 – 3.5	We agree that it is not appropriate to have a bridge bank with an indefinite lifespan. However, we consider that a fixed term of 12 months is too inflexible. Imposing any inflexible and rigid limits on the life of a bridge bank could affect whether or not the optimum price is obtained for the assets in any onward sale to a third party purchaser. For example, if a potential purchaser is aware that the bridge bank has been in existence for 11 months, it may offer less for the assets knowing that the Authorities have limited time in which to achieve a sale. This may be an inevitable consequence of any time period chosen in respect of the lifespan of the bridge bank. However, this potential for distortion and loss of value could be lessened by building into the regime an option for the Authorities to apply to the court to extend the life of the bridge bank (if, for example, the initial time period is close to expiring and negotiations for a sale are at an advanced stage but have not yet concluded). As the continuation of the bridge bank could affect the compensation rights of creditors of the original bank, we consider that such creditors should have the right to be heard by the court that considers the application to extend the life of the bridge bank (unless there is a compelling reason why such an application should be heard *ex parte*).
Partial transfers	
3.6– 3.10	We have grave reservations regarding the desirability and effectiveness of partial transfers of assets either to a private sector purchaser or to a bridge bank. We have set these out below. As a result of these concerns, we do not support the

	Authorities' proposals to introduce partial transfers as one of their stabilisation tools. *Preference of particular creditors* In practice, partial transfers will almost inevitably be a form of statutory preference. Counterparties whose liabilities are transferred to the private sector purchaser or the bridge bank with the valuable assets will be in a better position than those counterparties whose liabilities are left behind with the residual bank. This will occur not least because of the over-collateralisation of assets relative to liabilities on transfer to ensure continued compliance with capital adequacy requirements – this is indicated in paragraph 3.50 of the consultation. The SRR Consultation Paper suggests that the most likely scenario for a partial transfer is for the deposit book to be transferred to a private sector purchaser (paragraph 3.43) indicating, once again, that the main emphasis of the consultation process is on depositor rights. For the reasons given in our First Response, we query whether a partial transfer (and the detrimental effect that this would have on legal certainty) can be justified on the grounds of retail depositor protection and whether it is necessary in light of the suggested improvements to the FSCS. We would also question the practicalities of being able to transfer the deposit book as an isolated business. A bank's business is complex and it is not clear that the deposit book could always be neatly and cleanly severed from the rest of the bank's activities. We note the statement, in paragraph 4.22 of the SRR Consultation Paper, that no changes are proposed to the current statutory order of priority of creditors for distribution purposes in the modified liquidation regime. However, as a result of the partial transfer provisions and the objectives of protecting depositors and public funds, we consider that, in practice, depositors and the Authorities (as the providers of public funding) may well achieve a better result through the SRR than other creditors. This is clearly a policy decision but, if this is the intention, we consider that it should be acknowledged in the consultation process. *Legal and commercial certainty*

	The partial transfer provisions create legal uncertainty including the effect of the transfer on (a) contractual rights and obligations (see in particular our comment on question 3.1 above) and (b) security interests and close-out netting (see below). Partial transfers will also affect commercial certainty as a creditor of a bank will not know whether, in the event the bank is put into the SRR, its entitlement will be transferred or left in the residual bank. Because the powers place no limit on the Authorities' ability to effect a partial transfer, a creditor may suffer no loss following the implementation of the SRR (if the debt is transferred to the bridge bank or private sector purchaser), the creditor may recover nothing (if all the assets are transferred out of the residual bank, the debt is left behind and the bank resolution fund does not generate a return) or its recoveries may be somewhere between those extremes. Hence it will be difficult to advise a counterparty as to its position in the SRR. *Impact on set-off and netting* Partial transfer could also have a significant impact on set-off and netting. Banks currently manage credit risk on a net basis in reliance on the legal enforceability of set-off and close-out netting arrangements. Without appropriate protections, partial transfer powers could override netting arrangements (for example if "in-the-money" positions were transferred to the transferee but "out-of-the-money" positions were left with the bank) effectively leaving counterparties exposed on a gross basis to a bank in SRR. Although it is proposed that netting be addressed by providing for a carve-out for "qualifying financial contracts", this is not without its difficulties (see our response to questions 3.15 – 3.18 below). *Impact on collateral and security interests* A related risk is the destruction of certainty as to rights in collateral: the partial transfer powers would enable the Authorities to disassociate secured obligations from the collateral which secures them, effectively leaving counterparties unsecured. Although it is proposed that there be some carve-outs in this regard, the consultation does not go into any detail as to how this would work.

	Due diligence in relation to partial transfers To ensure that a proper price is paid and maximum value obtained, any partial transfer would require a thorough due diligence exercise in order to ascertain what are the healthy, good assets and liabilities that can be transferred to either a bridge bank or a private sector purchaser and what are the bad, worthless ones that will be left in the residual bank. Moreover, if the qualifying financial contracts or structured finance safe-harbours are introduced, a thorough and accurate due diligence exercise would also be necessary to ensure that no connected or inter-related contracts are inadvertently split up in the transfer process. There is little detail in the SRR Consultation Paper as to how, when and by whom such a due diligence exercise would be carried out. We note that the Authorities state that they will rely on the failing bank's records and regulatory documentation to make a quick and informed assessment regarding what assets should be transferred across and what assets should be left behind. Whilst in theory this works, it relies on the failing bank having adequate and accurate records. If a bank's failings are a result of poor management, it is unlikely that its records will have been well-maintained. The quickness and accuracy of the due diligence exercise may well impact on the price obtained for the assets and the value (if any) of the residual bank and therefore we would suggest that this aspect of the partial transfer proposals requires further consultation. *Safeguards for creditors* Critically, none of the consultation papers has set out any statutory protections for stakeholders in relation to the issues referred to above. Given the ramifications of partial transfer for stakeholders, such protections are essential; otherwise the loss of certainty as to counterparties' legal rights will damage confidence in the UK banking sector. That could result in increased, rather than reduced, financial instability. In particular, it is not clear what mechanisms and procedures there will be for stakeholders to challenge the transfer process, the asset selection process and the valuation of those assets and liabilities. What if stakeholders consider that the price obtained for the partial transfer was not the best one available? Will the remedy be for such stakeholders to bring an action against the Authorities for their role in implementing the SRR (in the same way as a disgruntled creditor

	might bring an action in negligence against an administrator who sold the assets of a company through a pre-packaged administration at less than their true value) or are the Authorities to have immunity from suit? Clearly it would have a detrimental effect on any transfer to a private sector purchaser if the stakeholders could overturn the transfer itself and so an action against the Authorities may be the only practical alternative. The necessary safeguards to mitigate the concerns raised in this letter must be enshrined in law and not in guidance. *Conclusions regarding partial transfers* For all of the reasons given above, we do not consider that the advantages of a partial transfer (in relation to providing greater flexibility when seeking to rescue a failing bank) can be justified in light of the potential cost in terms of legal and commercial certainty. We are aware that, in some special administration procedures (for example, for protected railway companies or PPP companies), the legislation allows for partial transfers of assets. However, in the few cases in which such special administration procedures have been used, the administrators attempted to achieve a transfer of the business as a whole possibly because of the difficulties that a partial transfer would have raised.
3.11 – 3.13	Given our grave reservations as to the desirability of partial transfers, we do not propose to comment on the subsequent transfer proposals but instead would simply note that any subsequent transfer power could again impact on creditors' rights. For example, there may have been secondary trading in the residual bank's debt and any subsequent transfer of assets may upset that position.
3.14	We consider that there is insufficient detail in the SRR Consultation Paper for us to be able to comment in relation to this question. We note, however, that it is assumed by the Authorities that a sale of the bridge bank to a purchaser in due course will generate proceeds of sale in excess of the costs of the resolution (so that the circumstances in which the creditors who are left behind with the residual bank will be worse off as a result of a partial transfer will be limited). In our view,

	it is by no means certain that this will be the case. We would expect management of the assets of the bridge bank to be challenging: existing management is likely to have failed and new management is unlikely to be familiar with the business. Management time will need to be given to the splitting of assets between the residual entity and the bridge bank and markets will be likely to move against the failing bank. For all of these reasons, we consider that there is a significant risk that the value of the bridge bank could fall rather than rise and hence we do not consider that the bank resolution fund should be the only avenue of compensation for a creditor of the residual bank. Furthermore, it is not clear from the SRR Consultation Paper how the bank resolution fund (or equivalent compensation provisions) would work in the case of a partial transfer to a private sector purchaser.
3.15 – 3.18	We believe that statutory safeguards for set-off and netting are essential. The ability to set-off and net financial arrangements is of enormous importance in managing credit risk. Furthermore, we believe that there would be a high likelihood that limiting the scope of netting so as to put the scope of any currently enforceable netting arrangement in doubt would have adverse consequences for the UK financial markets, by driving business offshore and increasing the cost of funding for UK financial institutions (for example by requiring such institutions to hold regulatory capital on a gross rather than a net basis). Introducing the concept of "qualifying financial contracts" will lead to carve-out complexity and is too arbitrary. We also query whether the legislation listing what types of contract are to be defined as "qualifying financial contracts" will be able to keep up with market developments and creativity.
3.19 – 3.20	Without appropriate safeguards, we consider that the SRR proposals could have a detrimental effect on structured finance arrangements because of the lack of legal certainty regarding the impact of the proposals on counterparty rights and therefore the difficulty that legal advisors will have in giving the necessary transaction opinions on which the rating agencies depend. However, it is difficult to see how an appropriate safeguard could be framed. Paragraph 3.76 suggests that this should protect "interconnecting parts of a structured finance arrangement from being separated in the course of a partial transfer". However,

	this could include a wide range of the failing bank's activities (for example if, in the context of a securitisation, the originator bank agrees to act as servicer of the loans). There is a danger that any carve-out wide enough to protect all structured finance transactions would effectively prevent partial transfers by requiring substantially all of the business to be kept together.
3.21 – 3.22	We agree that a safeguard to protect security interests could make a partial transfer more difficult. However, we do not consider that this difficulty justifies such security interests being overridden by the SRR. Holders of security have a legitimate interest in the realisation of that security. A loss of certainty as to a secured creditor's rights could have a damaging effect on confidence in secured financing arrangements and on the regulatory treatment of secured interbank lending. This is highly significant as banks engage in extensive secured credit relationships (particularly through repos, covered bonds and collateral under OTC derivatives). It is also not clear how any erosion of a secured creditor's rights in respect of financial collateral would sit with the UK's obligations in respect of the Financial Collateral Directive.
Special bank administration regime	
3.23 – 3.41	For the reasons given above, we do not consider that partial transfers should be allowed and therefore, in our view, there is no need for the special bank administration regime. We have therefore not considered in detail questions 3.23 to 3.37. However, we would make the following general points in relation to the proposed regime: • As the residual bank would almost certainly be insolvent, it would be necessary for the directors to commence the special bank administration regime immediately to protect them against wrongful trading liabilities. • We cannot see why the special procedure would be needed in the case of a partial transfer to a bridge bank but not in the case of a partial transfer to a private sector purchaser. • It is not clear whether the special bank administration regime would be an "insolvency proceeding" for the purposes of the Credit Institutions Winding-

	Up Directive so as to be recognised throughout the EEA. As the primary purpose of the procedure is to support the bridge bank (rather than its being a collective procedure for the creditors), it is doubtful that the proceeding would be recognised. • The concern for creditors in relation to the proposed purposes of the special bank administration regime is that they suffer a double hit. First they are left behind with the under-performing assets rather than being transferred to the bridge bank. Secondly, any (limited) resources or assets that the residual bank may still have are then to be utilised in order to support the bridge bank (rather than being realised in order to make a distribution to those creditors). Furthermore, the creditors will have little say in what are "non-essential" services and assets that the special bank administrator is able to realise in the interests of the remaining creditors. • The role of the residual bank is primarily one of support to the new bridge bank. It is unclear how this support role would work in practice. Presumably there will need to be agreements between the two banks. This assumes that the residual bank has the ability to enter into any such agreements and to make such promises of continued support and service provision. What if, for example, the essential service relates to IT that is licensed to the residual bank or intellectual property that is not owned by the residual bank – can the Authorities force a third party that is outside the residual bank's group party to continue to provide services? The matter becomes more complicated if the third party is not subject to the jurisdiction of the UK court. • We consider that the special administrator should be an officer of the court and the procedure should be commenced by order of the court in order to give creditors an opportunity to make representations as to who is appointed or to bring disputes before the court. • As a general comment, we do not consider that the usual rights and powers of creditors should be transferred to the Bank of England. In circumstances where those creditors have already been prejudiced by being left behind with the residual bank, we consider that it is even more important that they have some say in how the residual bank is managed.

3.42	We agree that it should. We note that nationalisation effectively involves state expropriation of shareholder rights. Share sales to a private sector purchaser have the same effect. The European Convention on Human Rights allows infringement of private law rights in this way only if appropriate compensation is provided. As discussed below, the quantification of compensation is a complex and controversial issue.
3.46 – 3.50	There should be adequate compensation for the infringement and erosion of private law rights but the quantification of such compensation is complex and gives rise to the following practical and legal difficulties: • How should one quantify the value of shares in a failing bank which is supported by the State (typically a failing bank will have had recourse to the Bank of England as lender of last resort, without which it would have become insolvent earlier)? • If there is shareholder value, how should one quantify loss to shareholders as a result of the operation of the relevant SRR tool? • What rights of recourse should be available to shareholders for mismanagement by the Bank of England and should this Authority have statutory immunity for its role? The concern with substituting shareholdings for unquantifiable compensation rights is that the consequent uncertainty could affect the ability of banks to raise capital in the markets – at a time when the banking industry is capital constrained. It is imperative that stakeholders have a right to challenge the valuation (and the valuation process) after the event. A purchaser, however, will want certainty that the consideration paid by it will not be subject to subsequent query or challenge. At the very least, it will be necessary to ensure that, even if the value of the consideration is called in to question, this would not unwind the transfer nor affect the purchaser's title to the assets. It is arguable that, if it is the Authorities that

	have procured the transfer, then they should be the ones compensating stakeholders for any loss resulting from a flawed valuation.
3.51-3.52	This is a policy issue on which others (e.g. the BBA) will be more qualified to comment. We note, however, that requiring the FSCS to bear the cost of the SRR is expanding the responsibilities of the FSCS significantly.
SRR tools: bank insolvency procedure	
	As a general comment, we note that the Authorities have taken on board the comments of a number of respondents to the January Consultation Paper and have sought to avoid making wholesale changes to existing winding up provisions. We welcome this approach. On this basis, we consider that the modified liquidation procedure is likely to be recognised as a collective insolvency proceeding for the purposes of the Credit Institutions Winding-up Directive although we would welcome the views of the Authorities in this regard.
4.1	These do not appear to be contentious.
4.2	The difficulty here for a liquidator will be in balancing the first objective (i.e. to engage with and assist the FSCS to ensure that depositors are paid out on a timely basis) with the second objective (i.e. winding up the affairs of the bank to achieve the best result for the bank's creditors as a whole). For example, it may be in the interests of the creditors as a whole to reduce costs by closing down the bank's operations and making the employees redundant, particularly in cases where there is no business to be saved. However, in order to assist the FSCS, the liquidator may be obliged to keep certain branches open and to retain certain staff for this purpose. As the first objective is to take precedence, it would appear that, in such circumstances, the liquidator would be obliged to keep the operations going even if this was not in the interests of the creditors as a whole. It is not clear why, from a public policy perspective, the rights of depositors should be more important in this respect than the rights of other creditors (including potentially employees and pensioners).

4.3	No comment.
4.4	As one of the main purposes of being on the liquidation committee is to be kept informed of the progress of the liquidation, we can see no reason why creditors other than (and in addition to) the FSA, the Bank of England and the FSCS should not be entitled to be appointed to the liquidation committee from day one. Such creditors have an interest in knowing what actions the liquidator is proposing to take to realise the first objective and what the costs of these actions are likely to be, particularly as such costs could have a direct impact on such creditors' recoveries (subject to the proposals that the FSCS would cover the costs of protecting eligible claimants[11]).
4.5	No comment.
Building societies and other issues of scope	
5.1 – 5.8	We think that it is right that the SRR should be applied to building societies as well as to banks. However, we would query what happens to the members of the failed building society. We presume that de-mutualisation would occur on the transfer of the undertakings to a bridge bank if such entity is a private company limited by shares but, in the case of a transfer to an existing building society, we think it would be useful if the legislation allowed a transfer of the memberships of the failing building society to the purchaser (as is the case pursuant to Building Society Act 1986). We also wonder whether special issues arise in relation to the transfer of part of the building society's undertaking to a bridge bank or private sector purchaser. Clearly the existing members will be left owning the residual building society that will now contain the unattractive parts of the business. In view of the typical profile of a building society member, the Authorities may have concerns about this from a public policy perspective.

[11] We find these proposals problematic as we are not convinced that a liquidator's costs will always be divisible between actions taken to protect depositors and actions taken to protect creditors more generally.

5.9	The possibility of a statutory creation, alteration or nullification is very worrying from a legal standpoint. Although the scope of the provision is not clear, the effect could be to negate counterparty rights and/or to subordinate the rights of market participants to those of the Authorities. To do so would be fundamentally prejudicial to counterparties, give rise to legal uncertainty and raise the costs of funding for UK banks.

Schedule 2 to the response of the CLLS Insolvency Law Committee

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SCHEDULE 2

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SCHEDULE 3

Proposed wording for clauses 96 and 134

First alternative (based on para 3, Sch B1 Insolvency Act 1986)

Clause 96 Objectives

(1) The bank liquidator must perform his functions with the objective of:

(a) working with the FSCS so as to ensure that as soon as is reasonably practicable each eligible depositor:

(i) has the relevant account transferred to another financial institution [with the support of payments from the FSCS or the Treasury to the other financial institution if necessary but without any obligation on the part of the bank liquidator to make any payments, or to transfer any assets of the bank, to the other financial institution], or

(ii) receives payment from (or on behalf of) the FSCS, or

(b) winding up the affairs of the bank so as to achieve the best result for the bank's creditors as a whole.

(2) The bank liquidator must perform his functions with the objective specified in sub-paragraph (1)(a) unless he thinks that the objective specified in sub-paragraph (1)(b) would achieve a better result for the bank's creditors as a whole.

(3) Once the objective specified in sub-paragraph (1)(a) has been achieved (or has become incapable of being achieved), the bank liquidator must perform his functions with the objective specified in sub-paragraph (1)(b).

Clause 134 Objectives

(1) The bank administrator must perform his functions with the objective of:

(a) supporting the commercial purchaser or bridge bank (see section 135), or

(b) rescuing the residual bank as a going concern, or

(c) achieving a better result for the residual bank's creditors as a whole than would be likely if the residual bank were to be wound up without first being in bank administration.

(2) The bank administrator must perform his functions with the objective specified in sub-paragraph (1)(a) unless he thinks either:

(a) that it is not reasonably practicable to achieve that objective or that objective has been achieved, or

(b) that the objectives specified in sub-paragraph (1)(b) or (c) would achieve a better result for the bank's creditors as a whole.

(3) The bank administrator may perform his functions with the objective specified in sub-paragraph (1)(c) only if he thinks:

(a) that it is not reasonably practicable to achieve either of the objectives specified in sub-paragraphs (1)(a) and (b) or the objective specified in sub-paragraph (1)(a) has been achieved and he thinks it is not reasonably practicable to achieve the objective specified in sub-paragraph (1)(b), or

(b) that the objectives specified in sub-paragraph (1)(c) would achieve a better result for the bank's creditors as a whole.

Second alternative (based on section 220 of the Greater London Authority Act 1999)

Clause 96 Objectives

(1) A bank liquidator has two objectives.

(2) Objective 1 is to work with the FSCS so as to ensure that as soon as is reasonably practicable each eligible depositor:

(a) has the relevant account transferred to another financial institution [with the support of payments from the FSCS or the Treasury to the other financial institution if necessary but without any obligation on the part of the bank liquidator to make any payments, or to transfer any assets of the bank, to the other financial institution], or

(b) receives payment from (or on behalf of) the FSCS.

(3) Objective 2 is to wind up the affairs of the bank so as to achieve the best result for the bank's creditors as a whole.

(4) The bank liquidator must perform his functions:

(a) for the achievement of Objective 1 and, once that objective has been achieved, for the achievement of Objective 2; and

(b) in a manner which protects the creditors of the bank.

Clause 134 Objectives

(1) A bank administrator has two objectives:

(a) Objective 1: support for commercial purchaser or bridge bank (see section 135), and

(b) Objective 2: "normal" administration (see section 137).

(2) The bank administrator must perform his functions:

(a) for the achievement of Objective 1 (unless he thinks that it is not reasonably practicable to achieve that objective) and, once that objective has been achieved, for the achievement of Objective 2; and

(b) in a manner which protects the creditors of the residual bank.