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Investment Banking Resolution
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19 March 2010

Dear Sir / Madam

Response of the Insolvency Law Committee of the City of London Law Society to the consultation document dated December 2009 entitled "Establishing Resolution Arrangements for Investment Banks" (the Consultation Paper)

Introduction and executive summary

1. The City of London Law Society ("CLLS") represents approximately 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 a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of the Consultation Paper has been prepared by the CLLS Insolvency Law Committee.

3. We are grateful for the opportunity to respond to the Consultation Paper. In view of the expertise of the CLLS Insolvency Law Committee, we have restricted our comments to the matters raised in Chapters 2, 5 and 8 of the Consultation Paper although we have also addressed a few additional questions from other chapters where we consider that these questions could have a significant impact upon the insolvency analysis. Although the other chapters raise important issues that could well affect how an investment firm is dealt with once an insolvency process is commenced, we understand that others (including other Committees of the CLLS) are intending to respond to these chapters.

4. In summary, we consider that a strong case needs to be made before any new insolvency procedure or modified insolvency procedure is introduced. There are now over 20 "special" insolvency procedures in the UK. This is hard enough for a UK practitioner to grasp, let alone an overseas lawyer. If this proliferation were to be replicated in every jurisdiction where an investment firm has operations, the number of insolvency procedures would be phenomenal. As well as adding to the overall complexity of the UK insolvency framework, there are related issues

such as secondary legislation not always being available prior to the commencement of the special procedure (e.g. railways and public private partnership special administrations) and the uncertainty that comes with any new procedure not having been tested through the courts before its utilisation.

5. Furthermore, we consider that the existing UK corporate insolvency procedures are extremely flexible and perfectly adequate for dealing with an insolvent investment firm, particularly in light of some of the pre-insolvency suggestions that have been made in the Consultation Paper. Although a case can be made for saying that deposit-taking banks and investment firms should be treated differently post insolvency because of the systemic risk that they may pose, many of the issues that an insolvency practitioner will face will be the same as for other large international corporates (e.g. Enron or World Com). Although the administration of Lehman Brothers International (Europe) (**LBIE**) is clearly highly complex, it now appears that distributions in relation to client assets may be made no less promptly than through the US SIPA process. Hence, any initial perception that there may have been that the US system gives rise to a more speedy resolution of the issues is likely to be dispelled by the time any legislation arising from the Consultation Paper is proposed. The administration of LBIE is obviously being carried out under the existing framework and Schedule B1 to the Insolvency Act 1986.

6. For these reasons, we very much support a "light touch" approach to any modifications to the existing administration regime for an insolvent investment firm. We wonder whether the proposals in Chapter 2 will make a significant difference in practice as we suspect that any administrator would follow principles similar to those set out in the proposed special administration objectives in any event (as indeed is demonstrated by the case of LBIE). Having said that, we do not consider that it would do any harm to set out the special objectives (and indeed we can see that both the administrator and the counterparties may welcome the clarity and transparency in this regard) provided that this is done in a way that maintains flexibility and allows the administrator to exercise a degree of discretion on a case by case basis. This will ensure that the special objectives do not become out of date and will assist in a "one size fits all" approach. Rather than lowering the standard of care for an administrator's duties (or attempting to come up with an alternative formulation for the standard of care), we suggest that an administrator will be sufficiently protected if the duties are linked to the pursuit of the special administration objectives.

7. We do think, however, that the proposals regarding a bar date for client asset and client money claims would be a useful modification to the insolvency legislation. The problem with the existing legislation is that, while administrators can impose a bar date for the submission of proofs of debt regarding unsecured claims and can, with the assistance of the court, impose a bar date for the submission of information regarding trust claims, such a bar date does not release proprietary claims in relation to the assets and so a recipient of any distribution from the administrators remains at risk that a third party will seek to attach those assets. We consider that it should be a matter for the discretion of the administrators as to whether a bar date is imposed in any particular case.

8. We are much more concerned about the proposals in Chapter 5 of the Consultation Paper and, in particular, the appointment of the Client Asset Trustee (**CAT**). We consider that these proposals are likely to add to the cost and complexity of the administration without giving rise to any real benefit. The experience in relation to LBIE has shown that it is just not possible to separate out the unsecured positions from the client assets; these have to be dealt with together in order to determine what client assets can ultimately be returned to a beneficiary on a net basis. The position may be different for a pure custodian but, even in such a case, there is no reason why a separate team at the accountancy firm from which the administrators are appointed cannot deal with the client assets (as PwC have done in relation to LBIE). To have separate officeholders appointed in respect of the client assets and the general estate would inevitably lead to duplication and potentially litigation regarding the respective roles.

9. On the cross-border side, we are pleased that HM Treasury is aware of the difficulties in this regard as it is essential that there is a harmonised, international approach to the insolvency issues. We doubt that the proposals in question 13 that international entities be able to "opt-in" to the UK measures will be workable. It is unlikely that the overseas court would cede jurisdiction and so the entity in question would simply be subject to two (or more) potentially competing regimes. There is no easy answer to the cross-border issues and ultimately we suspect that the UK Government can only legislate for UK firms while monitoring closely the international developments referred to in Chapter 8 to ensure that the UK proposals are not inconsistent with these developments. In this regard, we note that there is no mention in Chapter 8 of a proposed directive, from the European Commission, on insolvency proceedings in respect of a investment firm. As the paper correctly points out, investment firms currently fall outside the scope of the Regulation on Insolvency Proceedings (EC) No 1346/2000 (the **Insolvency Regulation**) and, unless the investment firm also has a deposit-taking licence, it is also carved out from the scope of Directive 2001/24/EC on the Reorganisation and Winding Up of Credit Institutions (the **Winding Up Directive**). It was our understanding that the European Commission did intend to propose separate European legislation for insolvent investment firms and it would be worth trying to find out where the thinking has got in this regard.

10. We have attached as Annex 1 to this paper a table which responds in more detail to the specific questions in the Consultation Paper. Any member of the working party (listed in Annex 2) would be glad to amplify any of these comments if requested.

The Insolvency Law Committee of the City of London Law Society
19 March 2010

Annex 1

Chapter 1 (Introduction)	
1.	*Do you have any comments on the proposed definitions of investment firm for the purposes of this work?* We note that the proposed definition would include a deposit-taking institution and therefore it is essential that sufficient thought is given to how the proposals in the Consultation Paper would fit with the special resolution regime and special insolvency regimes for deposit-taking institutions in the Banking Act 2009. This is considered further below. It is also important that thought is given to how the proposed definition would fit with cross-border legislation such as the Insolvency Regulation and any insolvency legislation that the European Commission may propose in the future in relation to investment firms. The Insolvency Regulation carves out "investment undertakings which provide services including the holding of funds or securities for third parties" and so this could well provide the definition for an investment firm in any European insolvency legislation in the future. This would appear to be covered by the proposed Condition 2 depending on the definition of client assets and, in particular, whether this is to include client monies (which in our view it should).
Chapter 2 (Enabling an Orderly Resolution)	
2.	*Do you agree with the Government's proposals for special administration objectives and associated policy measures? Are there any supporting levers not considered in this document that would be critical for the effective functioning of the special objectives?* As referred to above, while we consider that most administrators would already follow the objectives suggested in paragraph 2.16 of the Consultation Paper, we consider that there may be some merit (in terms of transparency for both the administrator and the counterparties) in having clear special administration objectives so long as the administrator maintains sufficient flexibility so that these can be adapted and applied, as appropriate, on a case by case basis. It is essential, therefore, that these are expressed in terms that are sufficiently broad and flexible to accommodate the vast variety of business models pursued by investment firms. In other words, the special objectives should refer to broad principles rather than being prescriptive as to how these objectives should be achieved. As the Consultation Paper recognises, it is a policy decision as to whether the return of client assets should be given procedural priority over the interests of unsecured creditors. It is important to recognise that even a procedural priority can have a practical impact on the quantum of returns to unsecured creditors. An extreme example would be in relation to a sale of the business. The administrators may receive two offers for the business, one from a purchaser who has the infrastructure and contractual relationships already in place to ensure a speedy return of the client assets and one who does not have the infrastructure and relationships but is willing to offer more for the business (thus resulting in a greater return for unsecured creditors). If the return of client assets is procedurally prioritised through the special administration objectives, the administrators would be required to accept the first offer at the expense of the unsecured creditors. Even outside of such an extreme example, where unsecured creditors have been procedurally subordinated to the

beneficiaries of client assets and monies, there could be a reduced return to unsecured creditors simply because of the increased timeframe in making distributions to them (and therefore the additional administration expenses that are likely to be incurred).

We have considered three options in relation to the prioritising of the special administration objectives:

(a) the first is for the legislation to set out the order in which the administrators must pursue these objectives (as is the case with the bank insolvency procedure (BIP) and the bank administration procedure (BAP)). This has the advantage of being clear from the administrators' perspective and may reduce the risk of challenge by third parties. However, it is the least flexible of the approaches and, from a policy perspective, the unsecured creditors may question why they are being procedurally subordinated;

(b) the second is for the legislation to set out the special administration objectives but without attempting to order them and then to provide that the administrators shall pursue the objectives in a manner which best protects the interests of the creditors and beneficiaries of the firm. This would leave it to the discretion of the administrators as to how to achieve the objectives in any particular case. While this is less certain than the first approach and the risk of challenge could therefore be higher, we consider that it would allow the administrators to adopt an approach that was appropriate for the particular investment firm in question and so is to be preferred;

(c) the third approach, which is a compromise between the two above, follows the approach in Schedule B1 to the Insolvency Act 1986. This does seek to order the objectives but allows the administrators to pursue a lower objective if they consider that it is not reasonably practicable to achieve the higher-ranking objective or if the lower objective would achieve a better result for the creditors as a whole. The problem with this approach in the current context is that there may be a conflict between the interests of the unsecured creditors and the beneficiaries of client assets and monies and so the concept of what would achieve a better result for the creditors as a whole would need to be adapted to reflect the interests of the beneficiaries.

In terms of the objectives themselves, we consider that these should include:

- the prompt return of client assets and client monies (rather than seeking to prioritise this objective for the reasons given above). Careful consideration needs to be given to the definition of client assets and client monies to ensure that these fit with the FSA definitions in the Client Assets Sourcebook (CASS);

- co-operating with the relevant authorities in the interests of achieving stability in the financial markets. We think it is worth adding this objective in view of the potential systemic risk that the insolvency of an investment firm might pose;

- ensuring timely engagement with market infrastructure bodies such as payment and settlement systems and clearing houses. While it cannot do any harm to include this as an objective, we note that the problem can often be the reverse – i.e. lack of communication by the market infrastructure bodies regarding how they will behave post an insolvency of a member. We hope that this will be addressed by proposals elsewhere in the paper;

- where this is in the interests of the creditors and beneficiaries of the firm, providing services and facilities to business transferred both in the run up to and post-

	insolvency. This objective should not be drafted too widely as there is a significant difference between BAP (which only ever arises following a transfer of the business) and the proposed administration of an investment firm where there may, or may not, be a transfer. Furthermore, we understand that, in the case of Lehman Brothers Inc (LBI), there is ongoing litigation with Barclays concerning the scope of what was sold to them and an unqualified duty to co-operate with a purchaser may adversely affect the interests of the creditors and beneficiaries in the event of such a dispute; • rescuing the investment firm or its business as a going concern or achieving an orderly winding down of the investment firm's affairs, as appropriate. While we suspect that rescue will not be possible in the vast majority of cases, we do not think it should be excluded from the objectives in case there is a prospect that it could be achieved (for example through a sale of the business as a going concern).
3.	*What are your views on introducing a limited restriction to the liability of the administrator, restricting creditors from taking action in certain circumstances, related to administrators' actions in pursuit of the SAOs?* We understand from conversations that we have had with the administrators of LBIE that concerns regarding personal liability have not been a major factor and, in particular, have not prevented them from taking any actions which they would otherwise have done. We also think it is important that the administrators have clearly defined (and properly understood) duties in order to ensure that the UK administration regime has a high degree of credibility both domestically and overseas. The problem with any alternative formulation of the duty (such as, for example, a duty to act in good faith) is one of certainty: one person's idea of good faith could be another's idea of bad faith. Instead we support the proposal that the duties be clearly tied to the special administration objectives. If the legislation clearly states that the administrators must perform their functions with a view to furthering these objectives (see paragraph 3 of Schedule B1 to the Insolvency Act 1986), we consider that it would be difficult for a counterparty to bring an unfair harm or negligence application against the administrators in circumstances where they were acting in accordance with those objectives.
4.	*What are your views on the suggestion that the personal liability of administrators should not be greater than that of the company's directors before the company went into insolvency?* We do not consider that this is appropriate. Directors and administrators fulfil two entirely different functions; the former have a primary duty to the firm's shareholders at least while the firm is solvent, the latter have a primary duty to the firm's creditors and beneficiaries. See our response to question 3 above.
5.	*Do you agree with the Government's approach to the court process for clarification around liability? What kind of expedited court process could be considered? Should one be required?* We do not consider that this is appropriate in light of the role that the English court currently plays in an insolvency process. The approach of the English judiciary to date has very much been to leave commercial judgments to the insolvency officeholders who, in the judges' views, have more experience of life at the coal-face than the judges do. We consider that there is a lot to commend this process as it reduces the costs associated with large numbers of court applications and lets those with the relevant experience make the commercial judgments.

	Furthermore, it should be remembered that the English court system is very different from that in the US. While it is becoming court practice in the UK to have a single judge allocated to a particular insolvency proceeding, this will not always be the case. There are no "specialist" insolvency courts (as there are in the States) and the judges tend to be ex-barristers rather than ex-insolvency practitioners with specialist knowledge of the proceedings in question. Finally, in our experience, when an application to court is urgent, it is usually possible to get before a judge very quickly (often out of court hours) and so we do not see any need for an expedited court procedure.
6.	*Is there any other approach the Government could consider with respect to the modification of administrator liability for the purposes of the special administration regime for investment firms?* See our response to question 3 above.
7.	*Do you agree with the Government's approach in providing a special defence for directors of investment firms against actions taken by administrators and others, to enable directors to implement resolution plan actions in the interests of the firms' creditors and of financial stability? What specific modifications could the Government consider applying?* We do not consider that any changes are necessary. The test (as the Consultation Paper points out) is whether the directors took every step to minimise loss to creditors on becoming aware that an insolvent liquidation is not avoidable. If it is in the interests of creditors to pursue a resolution plan or other resolution actions as agreed with the FSA, the directors will not be liable under the existing legislation. If the resolution plan is not in the best interests of creditors, it is questionable as to whether the directors should be adopting that plan. If the resolution plan is intended to promote financial stability (for example) but is not necessarily in the interests of the firm, its creditors and beneficiaries, this would put the directors in a difficult position, not just in relation to their wrongful trading liabilities under section 214 of the Insolvency Act 1986 but also in relation to their common law or statutory duties. If it is the intention to protect the directors in these circumstances, careful thought will need to be given to how the protections are worded as it could lead to a loss of confidence in the corporate governance of UK investment firms if directors are absolved from liability in circumstances where (it could be argued) they should be at their most vigilant. We have considered whether the reference to creditors in section 214 of the Insolvency Act 1986 ought to be broadened (in the case of an investment firm) to include beneficiaries of client assets and monies. We do not consider that this is strictly necessary as such beneficiaries are potential creditors of the firm if and to the extent that the firm breaches its fiduciary duties in relation to such assets and monies. However, in light of the narrow definition of "creditors" that was taken by the court in relation to the proposed LBIE scheme of arrangement, we would have no problems with a clarificatory amendment to section 214 to refer to the firm's beneficiaries as well as creditors when taking every step to minimise their loss.
8.	*Do you agree with the proposals for the initiation and scope of the special administration regime for investment firms and its interaction with the provisions of Part 2 of the Banking Act 2009, as described in Box 2A?* We consider that, in order to minimise the number of insolvency proceedings, the special administration regime for investment firms should become the standard administration procedure for these types of entity. Hence we consider that the regime should be commenced in exactly the same way as the standard administration procedure. In other

words, the directors, shareholders or creditors of the firm should be able to commence the process (in addition to the rights the FSA has to do so under the Financial Services and Markets Act 2000) on the grounds that the firm is unable to pay its debts or is likely to become so. Provided that no equivalent of the special resolution regime for deposit-taking banks is introduced for non-deposit taking investment firms (see our response to question 15), we do not consider that it is necessary to introduce conditions linked to financial stability.

In considering how the special administration regime might interact with the Banking Act 2009 for an investment firm that also accepts deposits (referred to below as "mixed bank"), we consider that it is necessary to consider two scenarios:

(a) circumstances where the mixed bank has been subject to the special resolution regime and, in particular, a property transfer instrument. Pursuant to section 34(7) of the Banking Act 2009, the property transfer may include a transfer of client assets and client money (although it need not do so) and it would be useful if confirmation could be given that the powers under section 34(7) would not be used so as to re-write the terms on which the client assets and client money are held by any transferee. In these circumstances, but for any changes that may be made to co-ordinate the two processes, the residual mixed bank may well have been placed into the BAP. The interaction between the investment firm special administration regime and the BAP will depend on what exactly has been transferred by the property transfer instrument (and whether this includes the client assets and client money) but provided that the investment firm special administration regime includes, as one of its objectives, the provision of services to the transferee, it should be possible to disapply the BAP and rely on the investment firm special administration regime in these circumstances;

(b) circumstances where, but for any changes made to co-ordinate the two processes, the mixed bank would have been placed into the BIP. In these circumstances, it would seem sensible to add to the special administration objectives for the investment firm special administration regime an objective similar to Objective 1 in section 99(2) of the Banking Act 2009 (to protect eligible depositors) so that the investment firm special administration regime could be used instead of the BIP. This objective would clearly only apply in the case of a mixed bank and we suspect that, from a policy perspective, you would want to ensure that this objective had procedural priority so as to be consistent with the approach taken in paragraph 99. In practice, however, we suspect that any administrators would pursue the special objectives in relation to eligible depositors in parallel with the other objectives including those in relation to client assets and money.

We note that, in Box 2A of the Consultation Paper, you state that no estate or client assets would be used in the payout of eligible depositors. We agree with this statement in relation to compensation payments made by the FSCS. Furthermore we agree that client assets should never be used to protect eligible depositors. However, we are not convinced that estate assets could never be used in transferring the relevant accounts to another financial institution pursuant to section 99(2)(a) of the Banking Act 2009. Much depends on how this section is to be construed but it is likely that a third party institution would only accept a transfer of deposits (i.e. liabilities of the bank concerned) if matching assets were also transferred to it. Part 2 of the Banking Act 2009 does not state that these matching assets must always be provided by the FSCS rather than the failed bank. In this regard, we refer to paragraph 13 of our response to Parts 2 and 3 of the Banking Act 2009 (accessible at: http://www.citysolicitors.org.uk/FileServer.aspx?oID=488&lID=0).

9.	*Is there a case for considering provisions in the special administration regime for investment firms in relation to new financing? The Government also welcomes feedback on the potential legislative or other hurdles to an investment firm obtaining additional funding from third parties in the period immediately before insolvency to close out its positions. Are there other issues or options in relation to intra-day support that the Government might need to consider?* We would strongly discourage you from introducing any changes regarding the priority of post-administration funding or funding made immediately prior to administration. As the Consultation Paper notes, this was the subject of a recent consultation process by the Insolvency Service in relation to general corporate administration and the issues raised are highly complex particularly as secured creditors' proprietary rights are likely to be affected. This could ultimately affect a lender's willingness to lend or an investor's willingness to invest. The Insolvency Service has decided (for good reason) not to introduce changes of this nature at the current time. Ultimately the lessons learned from the Lehman Brothers experience (and the difference in the ability of LBI and LBIE to raise funding prior to the commencement of insolvency proceedings) show that, what matters most to lenders and investors is whether there is Government or State support for that lending or investment. We doubt that there is anything that could be done on a legislative or regulatory front that would encourage third parties to lend without that support.
10.	*The Government considers the costs to market participants of implementing the special administration regime, with provisions for special administration objectives, liability of insolvency professionals and directors, and possible legislative changes for intra-day support to be negligible.* *Do you agree with the cost suggested in the paragraph above? If not, please provide an estimate of the costs that are likely to occur, stating your assumptions.* It is important to bear in mind the costs associated with any risk assessment in relation to the new regime that will need to be taken by counterparties of a UK investment firm. This could involve (for example) obtaining legal opinions regarding the impact of the new process on counterparty rights and reviewing documentation to ensure that, for example, events of default are triggered by the new procedure. In this regard, the greater the changes made by the proposed legislation, the more extensive the legal analysis is likely to be. If anything is unclear, this will also add to the costs of the risk assessment. Hence we doubt that the costs will be negligible although we are not able to quantify what those costs would be.
11.	*The Government would welcome views on the types of communications methods market participants would prefer and the type of information they would like to receive from the Authorities in case of an investment firm failure.* This question is beyond the scope of the Insolvency Law Committee and so we leave it to other interested parties to respond. We would note in passing that, in the LBIE administration, the PwC website has been an effective method of communication including by written statements and, in the early days, short video briefings and we would encourage the use of such tools in the future.
12.	*The Government considers the costs to market participants of a resource centre providing best practice guidance to administrators, and plans for coordinated market communication in the event of investment firm failure to be negligible, as these would require no market action.* *Do you agree with the cost suggested in the paragraph above? If not, please provide an*

	estimate of the costs that are likely to occur, stating your assumptions. Agreed.
13.	*Do you agree with the Government's proposal for international entities not subject to these proposals to be able to 'opt in' to the firm-level resolution regime?* As stated above, we do not think this is workable as we very much doubt that the overseas court would cede jurisdiction to the UK in which case the international entity would be subject to two possibly competing regimes.
14.	*Are there any other specific issues in relation to cross-border investment firms, not considered here or in Chapter 8, that need to be addressed?* As referred to above, we would like to know whether the European Commission still intends to adopt European legislation relating to the insolvency proceedings of an investment firm where neither the Insolvency Regulation nor the Winding Up Directive applies. We think it is important that any UK legislation is consistent with any such European legislation (or there is scope to modify the UK legislation if such European legislation were to be introduced in the future).
15.	*The Government welcomes views on the extent to which the package of measures proposed in Chapters 2 and 3 will contribute to achieving the effective resolution of investment firms. Do you believe there is a case for the measures to be further enhanced by a special resolution regime for investment firms?* We consider that the proposals in Chapters 2 and 3 would be sufficient to achieve the effective resolution of a failed investment firm and we do not consider that those proposals need to be supplemented by those in Chapter 5. We are also strongly against the idea of a special resolution regime for an investment firm. While it is arguable that this may be necessary to protect depositors and to restore confidence in the case of a failing deposit-taking institution, we consider that the significant interference with contractual and proprietary rights that such a regime involves cannot be justified in the case of a failing investment firm. The safeguards that would be necessary to protect legitimate expectations, trust property, set-off and netting would be even more complex than in the case of a bank and we would strongly discourage you from such a route.
Chapter 4 (Reconciling and returning client property)	
35.	*Should the Government look to provide clarity over how shortfalls in client asset omnibus accounts are treated on insolvency? Should the Government look to provide clarity over when clients' entitlement to their assets should be calculated?* We think this would be useful as there is currently a tension between a pro-rata sharing of shortfalls (which may well be the most practicable method of sharing such losses) and a "tracing" approach which may allow particular beneficiaries to identify "their" assets ahead of other beneficiaries. This is not likely to cause an issue in the LBIE administration as the level of shortfalls is expected to be very low (less than 3% of the client assets) but it could be an issue in a case where the shortfalls are higher. However, a decision first needs to be taken as to whether client assets are to be treated on a pooled basis or a stock-line by stock-line basis and whether a distinction needs to be made between pure custody assets and assets held pursuant to prime brokerage and other arrangements.

	In relation to the first point, we consider that it is more consistent with the UK legal system (which is based in trust law) for client assets to be treated on a stockline by stockline basis rather than securities of different types being pooled. In other words, if a client has an interest in M&S shares, that client should share any shortfalls re M&S shares pro rata with any other clients with an interest in M&S shares but those M&S shares should not be pooled with (say) Microsoft shares. Any system which relies on pooling (for example the UK CASS rules in relation to client money or the US SIPA rules in relation to client assets) results in a slower return of the monies or assets in question as it is not generally possible to make distributions until all the monies or assets have been collected in and all the claims determined. As for whether there should be separate "stockline" pools for pure custody assets and other types of client assets, we can see why a client whose only relationship with the investment firm is a custody one would want their assets to be separated from other types of client assets where the risk of shortfalls (for example as a result of improper use of rights of rehypothecation) might be higher. We note that the LBIE Claim Resolution Agreement separates custody and non-custody assets for precisely this reason. We wonder whether this decision is best left to the insolvency practitioner who can decide on the facts of the particular case whether there should be separate stockline pools for custody and non-custody assets (although the counter-argument is that the market may welcome the certainty as to how shortfalls will be dealt with).
45.	*Do you agree with the Government's proposal of limiting the transfer of client money to affiliates and jurisdictions where there are potentially interoperability issues with CASS?* We would strongly support this proposal. In our experience, there may be few contractual restrictions on the use of affiliates in other jurisdictions as the bankers of client money and it is not uncommon that, in a group insolvency scenario, those affiliates will fail at the same time as the investment firm in question. We think it is important that investors are made aware of the fact that they will always be subject to the credit risk of the bank holding the client money at the end of the day; even in jurisdictions that recognise the trust, the relationship between a bank and a depositor will generally be one of debtor and creditor (rather than trustee and beneficiary). The consequences for an investor are clearly much greater, however, when the bank fails at the same time as the investment firm. As this is more likely to happen when the bank and the investment firm are part of the same group, there is an argument for prohibiting (or at least limiting) the use of affiliates as the bankers of client money. Of more concern than the risk of there simply being a debtor / creditor relationship between the bank and the depositor are local insolvency law provisions that require the subordination of affiliate claims. The dispute between the insolvency officeholder of Lehman Brothers Bankhaus AG (Bankhaus) and the administrators of LBIE regarding client money deposited with Bankhaus has caused real concerns in the market in this regard; if LBIE (rather than the underlying clients) is treated as being the creditor of Bankhaus, and LBIE's claim is subordinated on the basis that it is an affiliate of Bankhaus, this will obviously have a very significant impact on any recoveries from Bankhaus in relation to the client money. There may well be jurisdictions in which these types of concern do not arise and so a blanket prohibition (or restriction) on the use of affiliates as the holders of client money may not necessarily be appropriate (subject to the points made above regarding the double impact of an insolvency of the investment firm and the bank). An alternative option would be to require the investment firm to obtain a legal opinion from the jurisdiction in question confirming that the protections given by CASS would be respected in the local jurisdiction and there would be no subordination of claims on the basis of the affiliate relationship.

48.	*Do you agree with the Government's proposals for establishing bar dates for client claims? How should clients' rights to their money and assets be affected by a failure to summit a claim by a bar date? Should the Government impose a legal duty on an administrator or trustee to impose a bar date?* We consider that provisions empowering an administrator to set a bar date by which beneficiaries would be required to submit information regarding their client money or client asset claims would be beneficial and could lead to an earlier return of the money or assets in question. It is important that these provisions should not be too prescriptive and so the length of the notice of the bar date (and indeed whether a bar date is appropriate at all) should be matters for the administrator's discretion. There are no provisions in the existing insolvency legislation regarding a bar date for trust (as opposed to unsecured) claims. Administrators can, with the assistance of the court, impose a bar date for the submission of information regarding trust claims (as the administrators of LBIE have done) but such a bar date does not release proprietary claims in relation to the assets in question and so a recipient of any distribution from the administrators remains at risk that a third party will seek to attach those assets. We consider that, if a beneficiary fails to submit information regarding its claim by the bar date, the administrators should be entitled to determine the beneficial interest of that beneficiary by reference to the books and records of the investment firm. The legislation should provide that the beneficiary loses its right to trace the assets into the hands of a third party so that distributions made by the administrators, in reliance upon information submitted by the bar date, cannot be overturned. We agree that, if information regarding a trust claim is submitted after the bar date, that claim should be converted into an unsecured claim against the estate. We are not sure we understand the second proposal in paragraph 4.82 regarding a subsequent pooling event. There are currently no provisions in CASS requiring a pooling of client assets (nor in our view should there be – we refer to our answer to question 35 in this regard). We also expect that, in many cases, there will be a single distribution in relation to client assets and so no opportunity for a catch-up distribution.
Chapter 5 (Providing clear and effective support for clients)	
52.	*Do you agree with the duties and proposed scope of the CAT? Should the scope be widened to include all investment firms? Should the Insolvency Practitioner be appointed from the same insolvency practice as the administrator or from an independent firm?* For the reasons given above, we are strongly against the idea of the CAT as a separate officeholder to the administrators of the investment firm. The experience in relation to LBIE has shown that it is often necessary to deal with unsecured claims and trust assets together in order to determine a beneficiary's net claim to the trust assets. This may be different for a pure custodian where no amounts are due from the beneficiary to the custodian but, in such a case, it would be possible for the administrators to come up with proposals for an early return of the custody assets. The proposals in relation to the CAT also fail to appreciate that it may take months (if not years) to work out whether the money or assets in question is trust money or assets or whether such money or assets were provided on title transfer terms. In this regard, it should be noted that, in the client money litigation involving LBIE, it has been assumed (for the purposes of the litigation) that certain parties were entitled to client money protection because the contractual position is so complex that this has not yet been determined as a matter of fact. Pending a determination of whether there is a trust relationship, it is not clear whether the administrators or the CAT would be responsible for dealing with such money or

	assets. As there could never be a clear delineation of roles (except perhaps in the case of a pure custodian), it is clear that there would be a degree of duplication between the tasks performed by the administrators and the CAT. This would lead to an increase in the costs of the insolvency process overall while achieving very little benefit. In light of our response to question 52, we have not responded to various of the questions set out below.
53.	*Do you agree with the Government's suggestions for how the CAT could be established? What do you see as the advantages and disadvantages of the two suggested legal methods of establishing a CAT?* See our response to question 52. Without prejudice to our view that there should be no CAT, we think the second of the two proposals in paragraph 5.12 is the only workable one as there may be prohibitions on transfer, registration requirements, clearing house requirements and other restrictions which prevent the assets being vested in the CAT rather than the company.
54.	*Should the costs of the CAT be funded from the client money and assets of the firm, or from the insolvent estate?* See our response to question 52. Without prejudice to our view that there should be no CAT, in light of the role that is proposed, we can see little basis for a suggestion that the CAT should be paid from the general estate rather than the client money and assets.
55.	*Do you agree with the proposal to establish a CAT? Should the Government favour alternative measures for improving client outcomes, such as the proposal in Chapter 2 to amend the legal duties of administrators to require them to prioritise the return of client money and assets?* See our response to question 52. We consider that the proposals in Chapter 2 (and in particular the clarification regarding the special administration objectives), the introduction of a bar date, the regulatory proposals regarding the reporting of client assets and money and restrictions on the use of affiliates as the bankers of client money (as referred to above) would be better ways of ensuring a speedy return of client money and assets.
56.	*It is expected that any additional costs of the CAT proposal would be negligible due to the assumed faster return of client money and assets by the CAT, and the resulting fall in expected administration costs. Do you agree? If not, please provide an estimate of any costs that are likely to occur, stating your assumptions.* We do not agree as we consider that the appointment of the CAT would lead to additional costs and would not result in a faster return of client money and assets. We are not in a position to provide an estimate of the additional costs.
57.	*Do you agree with the proposal that an individual from the CAA should be able to perform the CAT role, where this is desired by the regulator?* In view of our answer to question 52, we do not propose to answer this question.
58.	*Do you agree with the Government's proposal to set up a CAA? Do you agree that this should be established as a distinct body within the Financial Services Authority?* We consider that others (including the Regulatory Committee of the CLLS) are better

	placed to answer this question.
59.	*Should the FSA be granted powers to sit on the creditor and/or client assets committee by right, to enable it to monitor and, if required, challenge the administrator or CAT? Should such a power include the right to vote?* As the FSA does not have a direct economic interest in the client money or assets in question, we do not think it would be appropriate for the FSA to be granted powers to sit on the committees by right or to be able to vote on the matters considered at the meetings of such committees (e.g. on administrator's proposals). We have no problem with the idea of the administrators inviting the FSA to attend committee meetings in an observatory capacity where the administrators considered that this was appropriate. We would also expect the administrators to liaise closely with the FSA (and indeed we have suggested that this be set out in the special administration objectives).
60.	*Should all firms currently regulated by the FSA and holding client money and assets, as defined by the FSA's CASS rules, fall within the jurisdiction of the CAA?* We consider that others (including the Regulatory Committee of the CLLS) are better placed to answer this question.
61.	*It is expected that the FSA will allocate more resources to client asset risks in the future, to perform work that could be taken on by the CAA. The incremental costs of the CAA are therefore expected to reduce. Do you have any comment on this?* We consider that others (including the Regulatory Committee of the CLLS) are better placed to answer this question.
62.	*Do you have any other views on the establishment of a CAT or CAA that the Government should consider?* We refer to our answer to question 52.

Annex 2

Members of the CLLS Insolvency Law Committee's Working Group

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- Jennifer Marshall, Allen & Overy LLP