The City of London Law Society

4 College Hill
London EC4R 2RB
Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2
mail@citysolicitors.org.uk
www.citysolicitors.org.uk

Insolvency Law Committee response to the HM Treasury consultation on secondary legislation for non-bank resolution regimes

INTRODUCTION

1. The City of London Law Society ("CLLS") represents approximately 15,000 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 19 specialist committees. This response, in respect of the HM Treasury consultation paper published on 26 September 2013 entitled "*Secondary Legislation for Non-Bank resolution regimes*" (the "**Consultation**") relating to the extension of the Special Resolution Regime ("**SRR**") established by the Banking Act 2009 to undertakings in the same group as the bank, has been prepared by the CLLS Insolvency Law Committee. Members of the working party listed in the Schedule attached will be glad to amplify any comments if requested.

3. Our response focuses on three specific questions raised in the Consultation, namely:

- Whether we consider that the capital markets exemption should be included in the draft Banking Act 2009 (Banking Group Companies) Order 2013 (the "**Order**");
- Whether the current provisions are framed in "a sufficiently powerful but flexible way as to provide legal certainty"; and
- Whether there are any other entities which we would wish to see excluded.

The inclusion of the capital markets exemption in the Order

4. We agree with the inclusion of measures in the Order to protect capital market arrangements. While many capital markets structures would, in any event, fall outside the scope of the extended SRR because either (i) the issuer is an orphan SPV and is therefore not a subsidiary, and may not be a subsidiary undertaking, of the bank in question or (ii) the issuer has been incorporated outside the United Kingdom, this will not always be the case.

5. There will be capital markets products and structures which involve an issuer or credit support provider incorporated within the United Kingdom which may be a subsidiary undertaking of a bank (and thus potentially subject to the extended SRR). While it is clear

that the purpose of legislation is not to allow the Bank of England to exercise a stabilisation measure in relation to such entities, the theoretical possibility that this could occur (which may be highlighted in risk warnings relating to the product in question) could deter potential investors.

The drafting of the capital markets exemption

6. While the Order has been drafted so as to make it clear that capital markets arrangements should not fall within the extended SRR, we have identified a (limited) number of areas where there might still be some degree of legal uncertainty. The suggestions outlined below are intended to remove any such uncertainties.

Conformity with other relevant legislation

7. While we welcome the proposed carve-outs contained in the Order, we are concerned that there may be unnecessary uncertainty if some companies were categorised as "*securitisation companies*" for the purposes of regulation 4 of the Taxation of Securitisation Companies Regulations 2006, but fell outside the exemption contained in the Order which was intended to catch securitisation vehicles.

8. Similarly, the Consultation states that covered bond companies are intended to be excluded from the scope of the SRR, but uncertainty may arise, based on the current drafting of the Order, in relation to companies which own or manage assets directly or indirectly forming the whole or part of the security for a capital market arrangement. It would be an unhelpful outcome if such companies were caught within the definition of a "*covered bond vehicle*" contained in the Finance Act 2011, but might not benefit from the protection which the Order intends to give covered bond vehicles.

9. We would therefore suggest that the solution to the points highlighted in paragraphs 7 and 8 above would be to insert a new paragraph 2(3) in the Order, before the current paragraph 2(3), which would read:-

> *"The undertaking must not be either (i) a company or limited liability partnership which satisfies the requirements of sub-paragraphs (a) and (b) of paragraph 53(7) of Schedule 19 to the Finance Act 2011 or (ii) a company of a type referred to in regulation 4(2) of the Taxation of Securitisation Companies Regulations 2006."*

10. What is now paragraph 2(3) of the Order, to be renumbered paragraph 2(4), would then cover capital markets arrangements which did not involve a "covered bond vehicle" or a "securitisation company".

11. We believe that this approach has the obvious additional benefit of reducing the scope for uncertainty, and simplifying the relevant regime, by reducing the number of different rules that securitisation companies and covered bond vehicles need to comply with.

Bonds and commercial paper

12. The current definition of "*capital markets investment*" contained in the Order does not completely track the equivalent definition contained in Schedule 2A to the Insolvency Act 1986, as the definition contained in the Order appears to exclude issues of bonds and commercial paper falling within paragraph 3 of Schedule 2A.

13. It is not clear why the theoretical ability of the Bank of England to exercise a stabilisation option in relation to a SPV which has provided security would depend entirely on whether or not the relevant security had been provided in respect of bonds which had been rated by

a rating agency. As drafted, a SPV providing security in respect of bonds which are not rated, listed or admitted to trading (for example where bonds are issued to private placement investors) could be treated as a "banking group company" for the purposes of the Order, while a SPV which provided security for identical bonds which happen to be rated could not be treated as a bank group company and would therefore fall outside the scope of the SRR.

14. In order to avoid any uncertainty, and to ensure that money is not wasted in seeking an otherwise unnecessary rating for an instrument (in order to ensure that the SRR regime could not technically apply), it may be beneficial to include capital market investments falling within paragraph 3 of Schedule 2A within the definition of "*capital market investment*" contained in the Order.

Issuers

15. Paragraph 2(3) of the Order currently excludes from the extended SRR those providing guarantees or security in respect of capital market arrangements, but it does not expressly exclude the issuer of a capital market investment. We would therefore suggest that a new sub-paragraph (d) be added to paragraph 2(3), stating that an entity would also be excluded if its business was wholly or mainly "*to issue one or more capital market investments*".

Multiple issues

16. On many deals there is a single issue of capital market investments, but sometimes (especially under mortgage or credit card master trusts and covered bond programmes) there will be multiple issues over time. We would suggest that, to avoid any uncertainty, the carve-outs contained in paragraph 2(3) of the Order should be adjusted slightly to reflect this possibility (so that, for example, paragraph 2(3)(b) would read "*to guarantee the performance of obligations of a party or parties to one or more capital market arrangements*").

Multiple roles

17. Paragraph 2(3) of the Order currently provides that an entity would fall outside the SRR if its business is "wholly or mainly… (b) to guarantee the performance of obligations of a party to a capital market arrangement; or (c) to provide security for the performance of obligations of a party to a capital market arrangement." This wording (and, in particular, the use of the word "or") potentially leaves open to doubt the position of an entity which both guarantees and provides security for the performance of the obligations of a party to a capital market arrangement. We would suggest that any unintentional uncertainty on this point could be resolved by amending the introductory sentence of paragraph 2(3), so that it reads "the business of the undertaking must not be wholly or mainly one or more of the following:-"

Other entities which it may be appropriate to exclude from the extended SRR

Insurance companies

18. The current drafting of the Order appears to permit an insurance undertaking which is a bank subsidiary to be treated as a "bank group company" for the purposes of the Order. This could give the misleading impression that the Bank of England might exercise a stabilisation power under Section 81 of the Banking Act 2009 in respect of that insurance undertaking.

19. Any suggestion that such stabilisation measures could apply to insurance undertakings could create uncertainty and prove an unhelpful distraction should that insurance undertaking have to make definitive statements about the possible application of the Order in connection with any future capital raising. While it would be possible to include statements in communications with potential investors, setting out the legal and practical reasons why the SRR should not extend to insurance undertakings, it may be easier simply to add a new sub-paragraph to paragraph 2(3) of the Order, stating that the extended SRR cannot apply to an insurance undertaking.

Trustee/nominee companies

20. We believe that it may be worth considering excluding bank subsidiaries whose business is wholly or mainly to act as a nominee or trustee company, holding client monies and assets separately from assets belonging to the bank. While stabilisation measures would not, in practice, be exercised in relation to such entities, there may be an argument for making this point clear in the Order, so that any such nominee or trustee company can unequivocally reassure its customers on this point, should the need arise.

Warehouse companies

21. The current draft exclusions do not catch pre-capital markets structures such as bank-funded warehouse companies. Warehouse companies are important for building up the stocks of assets to be securitised, and as such they are fundamental to maintaining confidence in the stability of the capital markets themselves.

Other companies critical to securitisation

22. In order to address the “warehouse company” point discussed at paragraph 21 above and also to ensure that all appropriate structures used in capital markets arrangements are caught by the exclusions, we believe that (to the extent such structures are not already excluded by virtue of other provisions of the Order, and our proposed amendment, as set out in paragraph 9 above, is not adopted) an entity which is either a "note-issuing company", an "asset-holding company", an "intermediate borrowing company" or a "warehouse company" within the meaning of the Taxation of Securitisation Companies Regulations 2006 should be expressly excluded from the scope of the SRR. We would, however, emphasise that our strong preference, and recommendation, would be to make the amendment described in paragraph 9 above.

21 November, 2013

THE CITY OF LONDON LAW SOCIETY
INSOLVENCY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Hamish Anderson (Norton Rose LLP) (Chairman)

C. Balmond (Freshfields Bruckhaus Deringer LLP)
G. Boothman (Ashurst LLP)
T. Bugg (Linklaters LLP)
A.Cohen (Clifford Chance LLP)
P. Corr (Sidley Austin LLP)
S. Foster (Hogan Lovells International LLP)
S. Frith (Stephenson Harwood)
S. Gale (Herbert Smith Freehills LLP)
I. Johnson (Slaughter and May)
B. Larkin (Berwin Leighton Paisner LLP)
C. Mallon (Skadden Arps Slate Meagher & Flom (UK) LLP)
Ms J. Marshall (Allen & Overy LLP) (Deputy Chairman)
B. Nurse (Dentons UKMEA LLP)
J.H.D. Roome (Bingham McCutchen LLP)
P. Wiltshire (CMS Cameron McKenna LLP)
M. Woollard (King & Wood Mallesons SJ Berwin)

Working party for this consultation:

Jo Windsor (Linklaters LLP)
Gabrielle Ruiz (Clifford Chance LLP)
Jennifer Marshall (Allen & Overy LLP)