The voice of banking
& financial services

FINANCIAL STABILITY AND DEPOSITOR PROTECTION: SPECIAL RESOLUTION REGIME

BBA response to the tripartite consultation document

The British Bankers' Association (BBA) welcomes the opportunity to comment on the issues raised in the consultation document 'Financial Stability and Depositor Protection: Special Resolution Regime' issued by the tripartite authorities on 22nd July. We have also responded today to the more broadly based consultation on financial stability and depositor protection published at the beginning of July.

The BBA is the leading association for the UK banking and financial services sector, speaking for 223 banking members from 60 countries on the full range of UK or international banking issues and engaging with 37 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy.

THE SRR PROPOSALS: OVERVIEW OF THE BBA'S POSITION

- The BBA fully recognises the need for an SRR framework to be put in place and agrees that legislation establishing this should be progressed as a high priority.

- However we believe that it is of critical importance for this to be fully thought through and consulted on, and we share the widely held unease in financial markets and in the legal community that the proposed fast track timetable for legislation carries real risks.

- Our main concerns centre on the proposed sweeping powers that the authorities would have to vary or suspend creditors' rights, in particular in the context of partial transfers of the business of an ailing bank. In the absence of clear safeguards these could lead to damaging uncertainty, with serious implications for the funding costs of UK banks and their regulatory capital and large exposures requirements. The statutory objectives under the regime do not mitigate these concerns. It remains to be seen if these concerns will be allayed by the content of the secondary legislation. Also awaited is the proposed code of practice, though we do not believe that this would be a suitable vehicle for the provision of fundamental safeguards.

- We believe also that the possibility of interference in creditors' rights could seriously undermine the reputation and competitiveness of London as an international financial centre and UK financial markets generally.

- An area of acute concern is that the proposals would allow the Bank of England to cherry pick among certain types of contracts in master netting agreements and collateral arrangements, so compromising close out netting and collateral arrangements – the potential impact of this is underlined by the fact that in 2007 London accounted for 43% of global OTC derivatives business (with average daily turnover in excess of $1 trillion).

- The proposed allocation of SRR responsibilities among the tripartite authorities is endorsed, subject to suitable accountability.

- Also endorsed are the high level conditions for triggering the SRR, with reference to the threshold conditions. It is agreed that the test should not be purely 'mechanical' in nature and that the FSA would have to exercise its judgement in the light of all the circumstances.

- We accept that a range of resolution tools should be available to the authorities as the circumstances of an ailing bank could vary widely. We agree that the tools identified in the consultative document should be at the authorities' disposal. However this endorsement does not extend to the use of partial transfers where it is feared that formidable difficulties could arise. A clear exposition of the proposed binding safeguards for counterparties and other creditors, and cost-benefit analysis based on those safeguards, will be needed before a final view may be expressed.

- If there was to be a partial transfer of a bank's business to a bridge bank, it is recognised that a special bank administration procedure could be needed to deal with the affairs of the residual company. But more detail is required as to the safeguards for creditors of the residual company.

- For the most part the distinctive features of the proposed bank insolvency procedure are dictated by the context in which it would be used. But there remains ambiguity as to the proposed 'precedence' of the liquidator's duty to support the FSCS – and so uncertainty on the impact this could have on the position of creditors. Further clarification is needed.

- We do not believe that a convincing case has been made for the FSCS to be obliged to contribute to the costs of resolution under the SRR. These costs should be met by the acquirer of the banking business or, in insolvency, from the assets of the firm. In no circumstances should the FSCS be required to fund the payment of compensation to the shareholders of a failed bank.

DETAILED COMMENTS

NEED FOR AN SRR FRAMEWORK

1. The central emphasis in the authorities' overall reform package should be on measures to prevent a bank getting into serious difficulties. Accordingly we support the FSA's supervisory enhancement programme set out in the earlier July consultation document, together with the application of a process of 'heightened supervision' where necessary.

2. Nevertheless we agree that circumstances could be envisaged where actions by a bank's management and/or further regulatory intervention, of themselves, offered no realistic prospect of allowing the institution concerned to continue in business as a going concern. We agree also that it is necessary for the authorities to establish a legal framework in advance to address the possibility of such circumstances arising. Thus we support the SRR in concept.

TIMING OF LEGISLATION

3. The latest consultation document provides helpful further information on the operation and details of the SRR and this is welcomed. Even so, it leaves many questions unanswered. The industry is mindful that there are many critical outstanding issues – including creditors' rights generally, partial transfers, the scope of the netting, collateral and structured finance 'protections', the implications for group companies and the knock on effects for regulatory capital. In these circumstances, the BBA has serious reservations concerning the authorities' intention to introduce primary legislation to a very short timescale. Our strong preference would be for the SRR element of the legislation (or at least the part dealing with partial transfers) to be deferred pending a much more detailed analysis of the cost and risk factors arising – and the availability of draft secondary legislation setting out, inter alia, the key safeguards to be built into the regime. In this regard, it is noted that in his oral evidence to the Treasury Select Committee in July the Governor of the Bank of England emphasised that it would be far more important to get the SRR legislation right rather than to rush it to a fixed timetable, and left as an open question whether the authorities' proposed timescale for the legislation would prove to be feasible.

THE BUILDING BLOCKS OF THE SRR FRAMEWORK

4. The SRR framework will be a product of the primary and secondary legislation together with the proposed code of practice. Perhaps inevitably having three distinct building blocks for the regime complicates the task of assessment and this is accentuated by timing issues – including uncertainty on when the draft secondary legislation and the code of practice will be available for scrutiny. Certainly it will be important for stakeholders to have the opportunity to review the proposed arrangements on a holistic basis before any key decisions are taken.

5. One specific timing issue concerns the interrelationship between the primary and secondary legislation. It is understood that the authorities' wide ranging powers to intervene vis-à-vis creditors' rights will be covered in the primary legislation whilst at least some of the associated safeguards will be in the secondary legislation. The significance of this could depend on the elapsed time between the two. Even if the implementation of the relevant part of the primary legislation was deferred until the secondary legislation was in place, a material elapsed time period could have an important legal impact. In giving a legal opinion during this interval a law firm would have to pay regard to the

(known) pending powers of intervention but could not offer any comfort to a client in respect of any safeguards yet to be finalised. Similarly, banks raising capital during this period would need to include risk warnings associated with the powers of the Authorities, which may be expected to damage their ability to raise capital relative to other financial institutions. Any guidance that the authorities are able to provide on the expected timing of the secondary legislation would be welcome.

6. Turning to the proposed code of practice, whilst this could have a useful role to play we have major reservations on key elements of the proposed regime being consigned to a code – as appears to be the intention. As we understand the position, the status of the code would be non binding guidance. If this is correct, the code could not mitigate any legal uncertainty created by the legislation and a law firm could not place reliance upon it when drawing up a legal opinion. We have particular concerns about policy intentions regarding safeguards, especially safeguards for creditors' rights, being articulated in code – including provisions setting out the circumstances in which the partial transfers route could be used. The principles governing creditors' rights should be enshrined in the legislation itself.

ALLOCATION OF TRIPARTITE RESPONSIBILITIES

7. We agree with the proposed allocation of tripartite responsibilities for the SRR – in particular that the FSA should be responsible for the decision to invoke the SRR and the Bank of England for selecting the particular resolution tool. An example of the need for the closest co-operation between the authorities is the fact that a decision to invoke the SRR and the choice of tool would have to be announced simultaneously.

CONDITIONS FOR TRIGGERING THE SRR

8. We agree with the proposed high level conditions for triggering the SRR, focussing on a bank's current and expected future ability to satisfy the threshold conditions.

9. The need would be to strike the right balance between objective criteria and the exercise of judgement by the FSA informed by consultation with its tripartite partners. Given the enormity of a decision to set the SRR in train, not least for the shareholders of the institution concerned, there would need to be certain clear minimum conditions to justify this course of action – such as an ongoing breach of quantitative regulatory requirements evidencing an inability to meet the threshold conditions. At the same time, the authorities would need to pay regard to all the circumstances of the ailing bank and be clear in their own minds that there was no viable alternative but to place the bank within the SRR framework.

10. Even so, in some (though certainly not all) circumstances the decision on the timing of whether to invoke the SRR could be a difficult one. Obviously the FSA would not want to invoke the SRR 'prematurely'. Equally, however, the regulator would be aware that undue delay could result in further value being

destroyed in the business so reducing the chances of a successful resolution – and continued forbearance could increase the likelihood of the scale of the problems of the ailing bank becoming known to the wider market, causing the position of the bank to deteriorate still further and leading to (avoidable) systemic consequences. The prospect of the regulator facing such a dilemma serves only to underline that the overriding priority in the reform package overall must be the effective use of regulatory tools to minimise the likelihood of the SRR being brought into play.

11. On the proposed second condition for triggering the SRR – concerning a bank's likely future ability to satisfy the threshold conditions – more detail on how this judgement is promised in the proposed code of practice. It will be important that the proposed code is available for scrutiny as soon as possible.

12. It is understood that the Bank of England would need to take a close interest in the affairs of an ailing bank in advance of an announcement to trigger the SRR. This would be necessary for the Bank to be an effective consultee in the decision to invoke the SRR and to be in a position to select the most appropriate resolution tool. That said, we agree that it would be important for this not to result, in effect, in a period of dual regulation pre SRR.

SRR TOOLS

13. A variety of factors could be relevant in choosing an appropriate resolution response – in particular the nature of the difficulties afflicting the institution concerned, whether the problems were of a 'slow burn' or more dramatic nature, the systemic importance, size and complexity of the bank and the overall systemic context. We agree that a framework designed to accommodate a wide range of scenarios concerning a bank in difficulty should be able to provide the options proposed – the bridge bank, private sector purchaser and temporary public ownership solutions. Other things being equal, a private sector sale could typically be the least disruptive but it is recognised that this would not always be possible.

Bridge Bank

14. A key specific concern is raised by 3.21 of the consultation document, which proposes that on a transfer to a bridge bank it is likely that the failed bank's debt instruments would remain with the residual company. It is understandable that this should be the case for Tier 1 preferred capital, such as non cumulative preferred securities, but lower Tier 2 instruments, such as dated non interest deferrable instruments, should not be treated in this way. Such an outcome would potentially have a significant impact on the ability of UK banks to raise capital. This increased cost, in turn, could have negative implications for UK banks' credit ratings. The result would be further damage to UK banks' competitive position.

15. Under the bridge bank model the Bank of England would play a key role in setting strategic objectives and overseeing the management. Inevitably having the central bank involved in matters of commercial positioning,

possibly with bank also receiving public financial support, could raise competition policy issues. Partly for this reason, we agree that the life span of a bridge bank should be time limited.

16. Another issue would be the accountability of the Bank of England, in particular if mistakes were made in the running of a bridge bank leading to poor performance and loss of value. It is understood that the statutory immunity to be given to the Bank would not extend to these circumstances. This should be clarified in the legislation.

Private Sector Sale

17. One consideration to be borne in mind in a private sector sale is the possibility that this could place a counterparty in breach of large exposures limits – where it already had material exposures to the acquiring bank. Some regulatory forbearance would have to be exercised in these circumstances to allow the counterparty a realistic time period to remedy the position.

18. It is noted that a private sector transfer, depending on the size of the transfer, could raise competition policy issues – as pointed out in the consultation document. Attention also needs to be given to those aspects of company law which could have a bearing on the time needed for a private secor purchase to be effected.

Partial Transfers

19. From a viewpoint of effecting resolution, it is understood why the authorities would wish to have the option of progressing a partial transfer of an ailing bank's business. Nevertheless we have major reservations on the proposals for partial transfers, as these would leave a smaller pool of creditors with claims on the residual company which in all probability would be destined for insolvency. It is difficult to understand how this would be consistent with the stated aim of maintaining 'the priority ranking and equitable treatment of classes of creditors under existing insolvency law' – particularly in light of those of the statutory objectives which point to the protection of depositors and public funds. There will be a sense among creditors that they would be likely to be subordinated to depositors and the Bank of England (and possibly bank creditors, where financial stability is in issue). In the case of a partial transfer to a bridge bank, it is noted that creditors of the residual company would have a claim on the net proceeds of the sale of the bridge bank via the bank resolution fund. Similarly, where a partial private sector purchase (under property transfer powers) was effected the proceeds of the sale (less resolution costs) would be available for the compensation of creditors of the residual company. But in neither case would there by any guarantee that the sums concerned would be sufficient to compensate creditors fully for the losses inflicted by partial transfers. The additional compensation right proposed (to the extent known) is likely to be a poor substitute for creditor rights, as discussed below.

20. Apart from the inherent unfairness of a partial transfer solution, it would mean that potential counterparties of institutions that could be brought within the SRR would have to pay regard to the possibility of being left with claims on a terminally wounded company. The merest suspicion that a bank was facing difficulties could lead to the pulling of lines and acute liquidity problems. Also the implications for counterparties' regulatory capital treatment require clarification. Presumably the greater uncertainty as to the counterparty's loss given default, the higher the capital charge to the lender, which would in turn be reflected in an increased cost of credit for UK banks.

21. As noted earlier, we believe it would be inappropriate for safeguards applying to creditors in partial transfers to be set out in a non binding code of practice.

INTERFERENCE IN CREDITORS' RIGHTS

22. Closely linked to the partial transfers issue are the proposed broad powers to allow the authorities to override creditors' rights. The proposed latitude for interference in the rights of creditors of an ailing bank could have serious consequences for UK financial markets and we are surprised that the consultation document does not address this danger more explicitly. Not only could creditors suffer material financial losses ex post but the mere fact that the powers were in place would create a climate of commercial and legal uncertainty across the financial system. It is difficult to see how reputational damage and a loss of competitiveness for UK financial services could be avoided.

23. The consultation document does not discuss the regulatory capital implications for banks whose rights as creditors could be infringed by the proposed powers but it seems highly likely that there would be an impact in this area. Equally, as counterparties factored in the risk of interference in contractual rights it would be expected that capital and funding costs for banks would increase, particularly in periods of financial stress. At such times of risk aversion the possibility of contracts being abridged or suspended could have a marked effect on access to liquidity, credit and capital, so exacerbating market tensions. We believe that the introduction of powers in this area needs to be subject of detailed cost-benefit analysis, which as yet has not occurred. While cost-benefit analysis in this area will be necessarily difficult, the regulatory capital and funding cost implications can, we believe, be modelled, once the extent of the proposed statutory safeguards are known. It is essential that the Authorities undertake this analysis.

Netting and Other Financial Collateral Arrangements

24. On netting and other financial collateral arrangements, it is noted that the authorities would protect 'the types of financial contracts that are commonly entered into by counterparties in financial markets'. We take this to mean that counterparties' rights to close out a netting agreement on initiation of the SRR would not be infringed and that if termination was not invoked the authorities would refrain from cherry-picking among contracts subject to a netting agreement. As recognised in the consultation document, the importance of

protecting the integrity of close out netting agreements can hardly be overstated. Whilst impacts vary from firm to firm, estimates from member banks suggest that the use of such agreements typically reduces credit exposures by 70-90 percent. Other considerations apart, interference in netting agreements would have a major effect on regulatory capital requirements and large exposures compliance.

25. But protection would not necessarily extend to 'a number of different types of contracts which are not typically netted under a particular master netting agreement' – which would be designated as non-qualifying financial contracts (non QFCs). Whilst clarification is needed on the sorts of contracts the authorities have in mind here, the BBA believes that all legally enforceable master netting agreements should be protected. Close out netting is a valid and highly valued technique for risk reduction and management and to impose arbitrary restrictions on its use would send out the wrong signals. Also the QFC approach would be likely to lead to uncertainty at the margin as to which financial products passed the qualifying test. Cost-benefit analysis on the impact of the partial transfer regime absent detail on the scope of the QFC carve-out is impossible. It is essential that the authorities provide clarity on this in order to enable that analysis to occur.

26. The BBA has serious reservations on the possibility of interference in termination rights on a bank's entry into the SRR. However, if the authorities judged such a course to be essential to achieve resolution then it would be imperative for any moratorium to be as brief as possible.

27. Equally important would be that such suspension of termination rights was not accompanied by further variation in contractual terms. In particular, counterparties' rights to terminate for reasons other than the ailing bank's entry into SRR – for example payment default – would need to be fully safeguarded.

28. We have similar concerns in relation to the authorities' statement that there would be difficulties in safeguarding structured finance arrangements. Covered bonds have become an important financing tool and it will be important to find a way of safeguarding the assignment of mortgages from the bank to the LLP in a covered bond and other securitisation transaction so that a true sale can actually take place without the risk of it being subsequently overturned.

Security Interests

29. It is recognised in the consultation that, as a general rule, secured liabilities should not be separated from the assets securing those liabilities in a partial transfer. The need for this important safeguard is fully endorsed and we believe it should apply without exception. The one possible exception mooted in the consultation document – where a charge has been granted over most or all of an ailing bank's assets – describes circumstances which are considered very unlikely to arise. It would be better to eschew exceptions

altogether and to address the 'scope of charge' issue through regulation if this was felt necessary.

Group Companies

30. The consultation refers to the need for former group companies to continue to provide services to an ailing bank. To the end it is proposed that the Treasury should take powers to create, alter of nullify contracts between companies in a group containing an ailing bank. This proposal seems disproportionate to the objective cited and capable of destabilising other group companies as well as creating further legal uncertainty. Further issues would arise in the case of group companies incorporated outside the UK. More details are needed on the scope of this power before any considered view can be expressed: but a wide-ranging power with no controls around it is likely to extend the uncertainty issues flagged above to group companies of banks, which would impose a further cost on the industry.

Compensation

31. It is, of course, recognised that the proposals expressly provide for the payment of compensation to creditors whose rights have been infringed, and this is welcomed. However, the possibility of compensation does not allay our concerns regarding interference in creditors' rights. In short, an (unascertained) compensation right is not a suitable proxy for creditor rights. To begin with, creditors would face uncertainty as to whether and when redress would be forthcoming and whether the amounts of compensation payable would be commensurate with any losses incurred. In addition, it seems unlikely that compensation would address the operational/commercial disruption caused for creditors and the knock on effects for the business as a whole. On the latter, for example, it is possible that infringement of a contract could compromise firm wide risk management.

32. On a related matter, we note that the draft rules on compensation mainly address matters of process and procedure. It would be helpful in addition to have clarification as to the proposed principles of valuation – in particular on whether the intention would be that creditors should be fully reimbursed for losses suffered as a result of infringement of their rights.

Whole Business Transfers

33. In the consultation document the possibility of interference in creditors' rights is raised mainly in the context of partial transfers, though the powers being sought would apply more broadly. It is unclear whether the authorities envisage the possibility of such powers being used consequent upon whole business transfers. To the extent that such powers are used (and it is expected that, in relation to whole business transfers, contractual overrides on restrictions on assignment and termination rights will necessarily have to apply), then there must be clarity as to the scope of those powers.

Cross Border Issues

34. Clearly the proposals for partial transfers and the overriding of creditors' rights could have implications for branches of foreign banks and cross border counterparties. There is also the matter of the transfer of contracts subject to foreign law. As a general matter foreign law will not respect the transfer of contracts other than in a universal succession. This may drive overseas counterparties to seek to contract under foreign law and collateralise relationships offshore to avoid the possibility of contractual override or disenfranchisement by the authorities – with consequential economic knock-on effects for UK banks. 'Cross border' issues, including those arising where a bank is part of an international group, are not discussed in detail in the consultation document and would require further consideration.

SPECIAL BANK ADMINISTRATION PROCEDURE

35. It is accepted that a special bank administration procedure may be necessary to deal with the affairs of the residual company in the case of a partial transfer to a bridge bank.

36. The primary purpose of the procedure would be to ensure the continuation of the residual company to facilitate and support the operations of the bridge bank, with the Bank of England exercising a high degree of control over the process. The Bank would, for example, fulfil the role of the creditors' committee. Though there are references to the administrator paying regard to the interests of the creditors of the residual company, these are, for the most part, fairly muted. It is, of course, recognised that the creditors of the residual company would have an important stake in the success of the bridge bank solution through the bank resolution fund. Even so more information is needed on the safeguards to be put in place to protect the interests of these creditors in the context of the special administration procedure.

BANK INSOLVENCY PROCEDURE

37. It is noted that the authorities have brought the proposed model more in line with existing insolvency law and practice. This is welcomed. Further it is recognised that two of the distinctive aspects of the proposed procedure reflect the particular circumstances of bank insolvency under the SRR :

- the need for the authorities to have the ability to select and institute one of the SRR options (including the bank insolvency procedure) before a normal insolvency procedure could be set in train by another party.

- the need for the bank liquidator to engage with and assist the FSCS.

38. In the January consultation it was stressed that the bank liquidator's duty to act in the interests of creditors generally was subordinate to the requirement to support the FSCS in facilitating rapid compensation payouts. We had concerns that this could lead to creditors being unreasonably disadvantaged. Though the language used in the latest document is arguably 'softer' the

prioritisation remains and we are unclear as to what this would mean in practice. Draft clause 42 states that the bank liquidator's FSCS related objective takes 'precedence' over his duty to act in the interests of creditors generally and it is further explained that membership of the liquidation committee would be confined to representatives of the authorities until such time as the FSCS related objective was achieved. Taking these two elements together may suggest that 'precedence' refers to the sequencing of the liquidator's tasks rather than to a more fundamental prioritisation – but this is called into question by draft clause 42(6) which requires the bank liquidator to begin work on both objectives immediately on appointment. Clarification is needed on the intended meaning of 'precedence' in the draft legislation and the implications of this for the position of bank creditors.

PROPOSED FSCS CONTRIBUTION TO RESOLUTION COSTS

39. The deposit protection arrangements have been established for the express purpose of compensating depositors of failed institutions. The industry has strong reservations in principle to the scheme being used to meet the costs of the resolution of a failing bank or for other unintended purposes.

40. It is envisaged that certain resolution costs – administrative expenses and the cost of any public financial support – would be covered by the proceeds of the sale of a bridge bank, or in the case of a private sector purchaser by the funds paid for the banking business. Unless in either case the gross sale proceeds were insufficient to cover the costs in question there would be no need for a third party to underwrite these expenses. Subject to this 'sufficiency' proviso therefore it would seem that the authorities are looking to the FSCS to meet the remaining element of resolution costs - compensation claims arising from the SRR, notably from creditors of the ailing bank who have suffered loses as a result of having their contractual and/or property rights infringed.

41. It is difficult to see why the FSCS should be responsible for the costs of compensation where the operation of the SRR has resulted in the infringement of creditors' rights. Further, there are concerns that having passed these costs to a third party the authorities could feel less constrained as to the extent of interference in creditors' rights – resulting in a greater financial burden on the FSCS and thus the industry. It is noteworthy that while the protection of public funds is one of the high level objectives of the regime, there is not a more broadly based 'economy' objective for the SRR as a whole.

42. One of the arguments set out in the consultation document for asking the FSCS to contribute to resolution costs is that financial stability directly benefits the financial services industry. Whilst this is certainly true we do not think it provides a convincing rationale for industry funding of resolution. As recent events have demonstrated all too clearly, financial stability confers major benefits throughout the economy. We are mindful too that shortcomings in regulation can be a material contributory factor in a bank getting into difficulties.

43. The consultation document suggests that in certain circumstances the shareholders of a failed bank could be eligible for compensation. We believe there should be no question of the industry being expected, in effect, to subsidise the owners of failed competitors.

44. As set out above we are unconvinced by the arguments that the industry should contribute to the cost of resolution. These costs should be met by the acquiring company or from an insolvent bank's assets. However, if the authorities decide to proceed on the basis proposed we think it would be preferable to set up a separate arrangement for handling such contributions. This would be more transparent and allow the FSCS to concentrate on its core responsibilities.

British Bankers' Association
15th September 2008

APPENDIX: SPECIFIC QUESTIONS POSED IN THE CONSULTATION

SRR Objectives rules and governance

2.1) *Do you agree with the SRR objectives, as set out in draft clause 4?*

Yes, but we would suggest a further objective – namely to effect resolution in a cost effective manner.

2.2) *Do you agree with the role of the FSA in determining the conditions for entering the* SRR?

2.3) *Do you agree with the conditions for entering the SRR as set out in draft clause 7?*

2.2) – 2.3) **Yes.**

2.4) *Do you agree with the role of the Bank of England in operating the SRR in the public interest as set out in draft clause 8?*

Yes, but please see the comments in Paragraphs 14 and 15 of our response.

2.5) *Do you agree with the roles of the Treasury as set out in draft clauses 8(4), 8(5), 9 and 10?*

Yes.

2.6) *Do you agree that the SRR objectives should be supplemented by a code of practice?*

Please see the comments in Paragraph 6 of our response.

2.7) *Do you agree with the proposed areas to be covered in a code of practice?*

As immediately above

SRR tools: stabilisation powers and compensation

3.1) *What are your views on the breadth of the property transfer powers in clauses 14 to 23? Are there particular powers that are lacking?*

3.2) *What are your views on the nature of these powers?*

3.1) – 3.2) **Our views on the proposed powers are contingent on the safeguards to be included in the legislation. Please see the comments in Paragraphs 19 - 34 of our response.**

3.3) Do you consider that a company limited by shares, with the Bank of England as the sole or controlling shareholder, would be the most appropriate governance structure?

Yes.

3.4) Do you agree that the lifespan of a bridge bank should be limited? What do you think is an appropriate length of time?

Yes – such limitation would be appropriate.

3.5) Do you think that the extension of a bridge bank's lifetime should be subject to certain conditions? If so, what?

If there is judged to be a realistic prospect of selling the bridge bank to a private sector purchaser, the life of the bridge bank should be extended.

3.6) Do you think that partial transfers increase the chances of the successful operation and sale of a bridge bank and the chances of a private sector purchase?

Yes, but please see the comments in Paragraphs 19-21 of our response.

3.7) Do you agree that guidelines, setting out when partial transfers might be used, should be provided in the code of practice?

Please see Paragraphs 6 and 19-21 of our response.

3.8) Would these guidelines provide reassurances about how the Authorities might use partial transfers?

3.9) Do you agree with the situations in which it is proposed that the partial transfer powers could be exercised?

3.10) What is the appropriate level of flexibility for the situations in which these powers can be used?

3.11) Do you think the Bank of England should have the flexibility to make subsequent transfers between a bridge bank and a residual company?

3.12) Do you think the Bank of England should have the power to make subsequent transfers using the stabilisation powers?

3.*13) Do you agree with the restrictions the Authorities propose for subsequent transfers (that they should only occur between a bridge bank and a residual company and not involve moving liabilities from the bridge bank to the residual company)? Should there be additional restrictions?*

3.8) – 3.13) **As immediately above.**

3.14) *Do you think that the bank resolution fund is an appropriate means for compensating creditors left in the residual company?*

As noted we have serious reservations on the use of partial transfers. In the circumstances posited it is not clear that the net proceeds of the sale of the bridge bank would always be sufficient to provide the requisite compensation for creditors left in the residual company.

3.15) *Do you agree that an explicit safeguard to protect set-off and netting arrangements is required?*

Yes.

3.16) *Do you agree with the risks of adopting a complete master netting arrangement safeguard?*

3.17) *Should the qualifying financial contracts approach be adopted, what do you think should be defined as qualifying financial contracts?*

3.18) *Can you suggest any alternative options for how the safeguard might be framed in a sufficiently wide but workable way?*

3.16) and 3.18) **We consider that all legally enforceable master netting agreements should be protected.**

3.19) *Do you agree that an explicit safeguard to protect structured finance arrangements is required?*

Yes.

3. 20) *Do you have any workable suggestions for how the safeguard might be framed in a sufficiently wide but workable way*?

We consider that all interconnected parts of a structure finance arrangement should be safeguarded.

3.21) *Do you agree that a safeguard to protect all security interests could make a partial transfer practically difficult?*

We consider that all security interests should be protected. Please see Paragraph 29 of our response.

3.22) *Which security interests should not be covered by this safeguard?*

We consider that all security interests should be protected. Please see Paragraph 29 of our response.

3.23) *Do you consider that where part of a failing bank's business is transferred to a bridge bank, a special bank administration procedure may be required to deal with the residual company?*

Yes. Please see Paragraphs 35 and 36 of our response.

3.24) *Do you think that this special bank administration procedure should be confined to the residual company where a partial transfer is effected to a bridge bank or should it also apply, with any necessary modifications, where a partial transfer is effected to a private sector institution?*

To the extent that a similar arrangement might be required for a private sector sale the same logic would apply.

3.25) *Do you agree that the special bank administration procedure should have specific objectives?*

Yes.

3.26) *Do you agree with the objectives and their priorities as proposed above? In particular, do you agree that the objective of supporting the bridge bank should take priority?*

It would be helpful to have more information on the safeguards to be invoked for the creditors of the residual company.

3.27) *Should the grounds for commencing or applying for special bank administration be linked to the partial transfer of assets and liabilities to a bridge bank?*

3.28) *Should any other grounds be included in the legislation?*

3.27) and 3.28) **As we understand the position, a special bank administration procedure would only be introduced following a partial transfer**.

3.29) *Should the special bank administration procedure be commenced by an order of the court or initiated automatically by the direct appointment of a special bank administrator by the Bank of England?*

As the consultation document notes there are arguments in favour of both options. On balance, in the interests of avoiding delays, we would support the administrator being appointed by the Bank.

3.30) *Should the special bank administrator be an officer of the court, or in the interest of promoting the objectives of the SRR should he or she be subject to overall direction by the Bank of England, with the court ruling on any disputes arising in the resolution?*

We think that the administrator should be subject to the overall direction of the Bank, with the court ruling on any disputes.

3.31) *Are the moratorium provisions outlined above sufficient for the purposes of a special bank administration procedure? If not, what additional measures would be required?*

The provisions outlined are judged to be adequate.

3.32) *Do you think that the existing powers of an administrator would be sufficient for the purposes of special bank administration?*

3.33) *Should the special bank administrator be given any additional powers, including some or all of the powers of a liquidator outlined above? If so, what extra powers do you consider would be appropriate?*

3.32) – 3.33) **We would support the administrator having the first three additional powers identified.**

3.34) *Do you agree that the Bank of England should have a key role to play in the special bank administration procedure to facilitate the successful resolution of a bridge bank and to assist in the winding up of the residual company in the interests of its creditors generally?*

Yes.

3.35) *Should the Bank of England rather than an initial meeting of creditors be responsible for considering and agreeing to, with or without modification, the special bank administrator's proposals?*

3.36) *Should the Bank of England rather than creditors fulfil the functions of a creditors' committee?*

3.37) *Should the rights of creditors to challenge the conduct of the procedure be subject to restrictions to ensure that the principal objectives are not jeopardised?*

3.38) *Do you agree that there should not be any substantial change to the ordinary statutory order of priority of creditors in the special bank administration procedure?*

3.39) *Should any special provisions relating to statutory set-off be introduced within a special bank administration procedure?*

3.35) – 3.39) **We see the logic of these proposals but have some concerns as to safeguards for creditors of the residual company.**

3.40) *Do you agree that the procedure should only be terminated where the Bank of England provides consent?*

3.41) *Do you think that provisions should be made for a variety of ways to bring the procedure to a close, including conversion to ordinary insolvency procedures*?

3.42) Do you agree that temporary public ownership should be subject to similar public interest tests as the Banking (Special Provisions) Act 2008?

3.43) Do you agree that the Authorities should have the power to put in place a bank resolution fund for a bridge bank and temporary public sector ownership?

3.44) Do you agree that the bank resolution fund should be mandatory in the case of the bridge bank tool, but optional in the case of temporary public ownership?

3.45) Do you agree that the bank resolution fund should comprise only the net proceeds of resolution (that is, less the costs of resolution)?

3.46) Do you agree with the mechanisms for compensation and appointing an independent valuer in the circumstances set out above?

3.47) Do you agree with the proposals to confer specific powers on an independent valuer, and the nature of the powers described above and provided for in draft clause 28?

3.48) Do you agree with the principles of valuation set out in draft clause 30?

3.40) - 3.48) **We agree with these propositions subject to our overriding comments on partial transfers.**

3.49) Do you agree that the Treasury should have power to provide for the reconsideration of the independent valuer's determination and appeals from the valuer to a court or tribunal?

We believe that powers of appeal on valuations should be symmetric as to the parties concerned.

3.50) Do you agree that alternative compensation arrangements are needed for a private sector purchaser tool, that would not involve an independent valuer?

Further clarification is needed as to the precise arrangements the authorities have in mind and the reasons why an independent valuation procedure is considered to be unnecessary for the private sector purchaser tool.

3.51) Should any of the costs described above not be covered by the FSCS, under the Authorities proposals? Please explain why.

3.52) Are there any additional costs of resolution which could be borne by the FSCS?

3.51) – 3.52) **Please see the comments in Paragraphs 39 – 44 of our response.**

SRR tools: bank insolvency procedure

4.1) Do you agree with the provisions for entry into the bank insolvency procedure, as set out in draft clauses 38-41, 60 and 62?

Yes

4.2) Do you agree with the provisions for the appointment and objectives of the bank liquidator, as set out in draft clauses 37, 42, 46 and 47?

*4.3) Do you agree with the provisions for the powers and responsibilities of the bank liquidator, as set out in draft clauses 47, 48, 61, 63 and 6*6?

4.4) Do you agree with the provisions for the liquidation committee, as set out in draft clauses 44 and 45?

4.5) Do you agree with the provisions for the end of the bank insolvency procedure, as set out in draft clauses 50-58?

4.2) – 4.5) **Please see the comments in Paragraphs 37 and 38 of our response.**